Global Report

Office of the Comptroller of the Currency

International Banking and Finance
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Global Report—Executive Summary

International Economic and Financial Market Developments

A Global Overview

Evidence of an acceleration in the pace of global growth has become more pronounced since the summer. As a result, any lingering concern that the financial crisis would deteriorate into a major world economic deflationary slowdown has been dispelled. Analysts continue to anticipate that the U.S. economy will pause to take a breath next year, but they are confident that a stronger Europe will pick up the slack. Although Japan's economy is sputtering, the emerging world is performing better than expected. Concern about year-2000 events is reflected in a heightened demand for liquidity but has, so far, not proved serious enough to disrupt global capital flows. U.S. banks remain cautious about expanding their foreign exposure.

U.S. banks may well face more volatility in financial markets, which must adjust to the new mix of risks flowing from international developments. The improvement in global growth prospects has led to rising interest rates. This creates a more challenging environment for securities, many of which have experienced dramatic gains in recent years. Although bond prices have fallen, equity markets remain at, or near, historic highs in a number of countries. The burgeoning U.S. current account deficit, which is projected to expand further despite the pickup abroad, also adds to the potential for volatility. So far, foreign demand for U.S. financial instruments has remained strong. However, a slowing domestic economy coupled with improved prospects overseas may shift the relative attractiveness of investments. Any significant change in sentiment will quickly spill over into foreign exchange and interest rate markets.

Developments in Key Foreign Financial Sectors

- *Western Europe.* Activity in Western European capital markets increased sharply over the past year, particularly for corporate bonds. That market is small but, with a large pool of euro funds now available for investment, may grow to become an important alternative to bank lending. The pace of banking sector mergers has also picked up, driven by efforts to build market share, avoid hostile bids, and to reap economies from restructuring banking and insurance sectors. Bank consolidation has revealed latent nationalism in various countries and merger proposals are being affected by cross-shareholding among financial firms and their commercial clients. As the mergers result in more complex financial entities, European supervisors are scrutinizing existing supervisory structures to ensure effective supervision.

- *Asia.* Asian financial sectors are recovering more slowly than their macro-economies. Apart from Korea and China, financial institutions are not lending. Since banks are the main suppliers of credit in Asian markets, this is leading some to question whether the economic rebound is sustainable unless lending resumes. Two main obstacles impede financial sector restructuring. Banks' resources are still inadequate to restructure corporate loans, despite the significant amounts of capital that have been raised and/or the transfer of some nonperforming loans to government agencies. In addition, the corporate sector is unwilling to give up ownership interest or to cede some measure of control to banks as a condition for debt restructuring.

- *Latin America.* In Latin America, banking sectors in Chile, Brazil, Argentina, and Venezuela have withstood recessions, higher external funding costs, and market volatility over the past year. However, authorities had to intervene in institutions in Ecuador and Mexico and public banks in Colombia are in distress. Asset quality has suffered throughout the region, and credit growth has been flat. These conditions may stabilize, but may not improve soon. Leading banks (including foreign entities, which continue to expand) remain better positioned to withstand the stresses of the current economic environment because of their strong franchises, deeper capital bases, and ability to access domestic and international capital markets.

Summary of Major Points or Risks

- The consensus scenario calls for a gradual softening in the U.S. economy, with the current account deficit correspondingly shrinking, while overseas markets strengthen. If the United States fails to cool off, or the rest of the world picks up rapidly, competition for funds could cause significant volatility in international markets.

- Global equity markets appear vulnerable to a correction, which if deep enough has the potential to slow economic activity and to disrupt international capital flows.

- Unexpected developments stemming from the year-2000 date change remain a wild card.

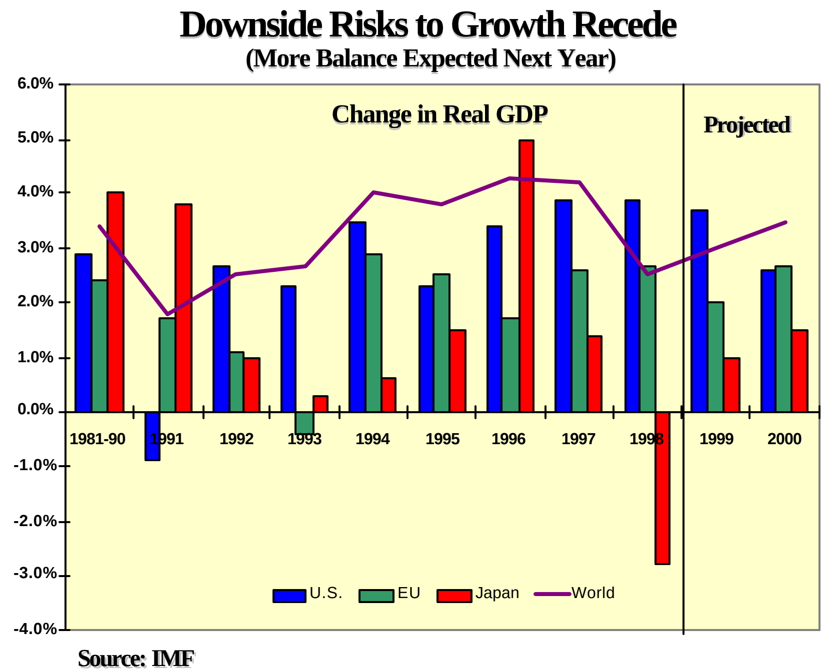
- Japan remains weak and there is some concern it could fall back into recession, which would hamper recovery in the rest of Asia. China is struggling to effect massive economic restructuring; policy missteps or a public loss of confidence in the financial system could prove destabilizing with serious potential spillover effect on the region.

- In Europe, risks in the banking sector appear to have been increased by the pace of merger and acquisition activities; supervisory authorities will be pressed to keep up with developments in complex financial conglomerates.

- In Latin America, a pickup in the pace of economic recovery in 2000 will be pivotal in spurring credit growth and in reversing asset quality deterioration. Bank supervisors' efforts to strengthen the evaluation of loan quality and bank accounting practices, particularly in Brazil and Venezuela, will be noteworthy in the near term. Foreign bank expansion, led by Spanish institutions, will continue to play a significant role in the consolidation of banking sectors.

Global Macro-Economic Outlook

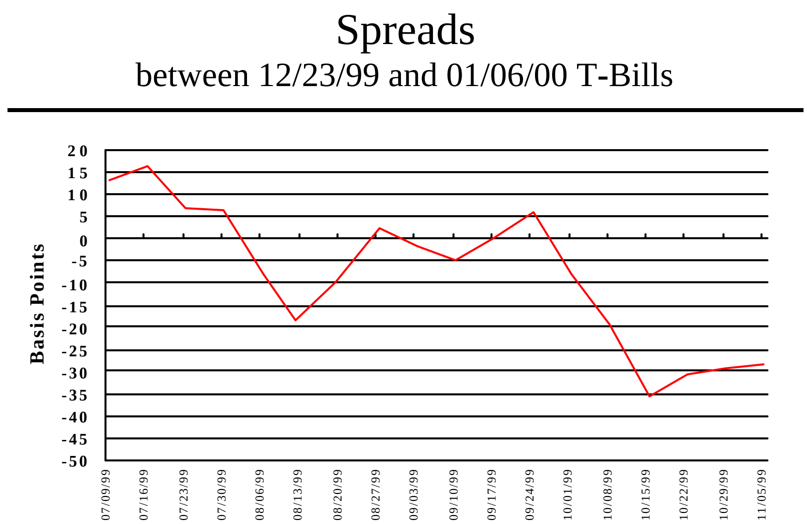
The fallout from the financial crisis that began in the second half of 1997 has now largely dissipated. Global economic activity picked up in the second half of the year and is projected to return to more normal levels in 2000. The United States, the only major industrial country to record consistently strong growth over the past few years, continued to outperform relative to other major economies in 1999. However, forecasters anticipate a better global balance next year as activity gathers steam in the European Community and the long anticipated slowing in the United States finally arrives. Japan appears to be past the worse but expansion will remain weak into next year and will fall well below average 1980's levels. Since the spring, projections for the developing world have improved markedly. Asia is recovering strongly and Latin America looks poised to record solid growth next year, after avoiding a steep fall in 1999.



There are risks to the forecast from year-2000 (Y2K) issues, although concern that breakdowns in critical systems in the major industrial countries will prove very disruptive has diminished during the year. To a lesser extent, this is also true for the emerging world. It is quite difficult to assess the potential impact of Y2K if preparations do in fact turn out to be inadequate, but it is clear costs could be substantial. For example, the International Monetary Fund (IMF) estimates that unprepared developing countries could lose on average 2 percent of gross domestic product.

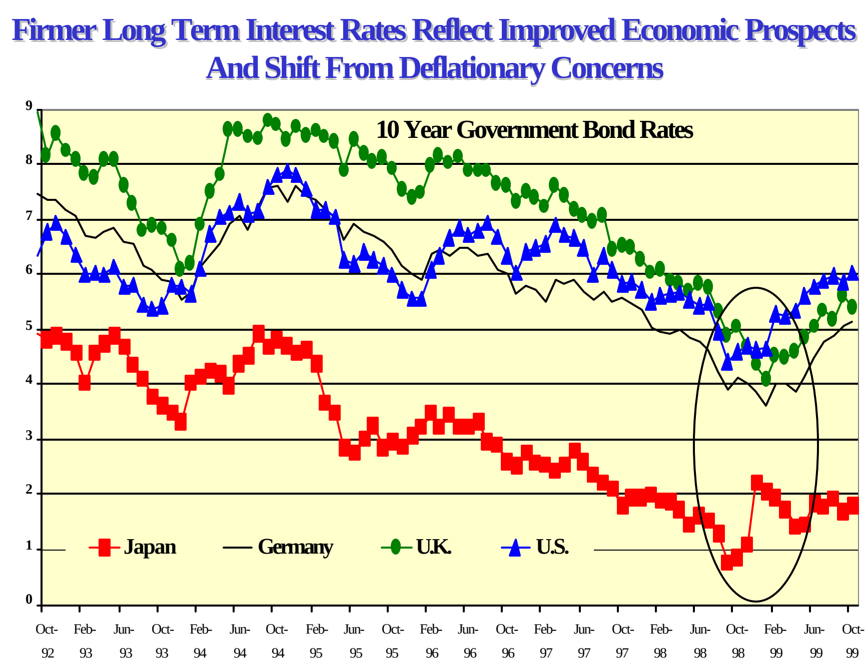
The century's end is influencing economic activity in other ways. Purchases of computers have been strong this year, presumably in part because of concerns about the Y2K compliance of older equipment. There is also some stockpiling of additional inventories in anticipation that supplies will not be available, or will be more costly, early next year. This has added to the economic momentum in the second half of this year, but will be at the expense of sales in 2000. This could produce a drag of activity in the beginning of next year, but analysts do not have a good sense of the order of magnitude or even whether it is likely to be noticeable.

There remains uncertainty about the reliability of data on readiness and the potential for unpredictable events associated with year-end 2000. This is contributing to greater caution in the financial markets and has raised the cost of holding funds over year-end. Earlier in the year, positions were adjusted to avoid end of year maturities, reducing liquidity for some products. However, recently liquidity has improved and the year-end premium has eased. Increased confidence in the state of preparations is an important factor. Monetary authorities are helping by increasing supplies of available currency and lines of credit. Sharp, unpredictable, swings in liquidity preference remain possible and could complicate monetary policy management and produce financial market volatility.



Data source: Bloomberg Analytics

Separately, international financial markets are moving in response to the change in global economic prospects. As we noted in the June "Global Report," the environment for securities has been extraordinarily favorable in the last few years, with steady declines in inflation and retrenchment in government financing requirements. The arrival and spread of the financial crisis in 1998 intensified demand for bonds by introducing the possibility of a spiraling down in activity and widespread deflation. In response, long-term interest rates in a number of countries fell to post-World War II record lows. Short- term rates also eased as monetary authorities provided additional credit. Recently however, with clear signs of stronger growth afoot, the risk of deflation has abated.

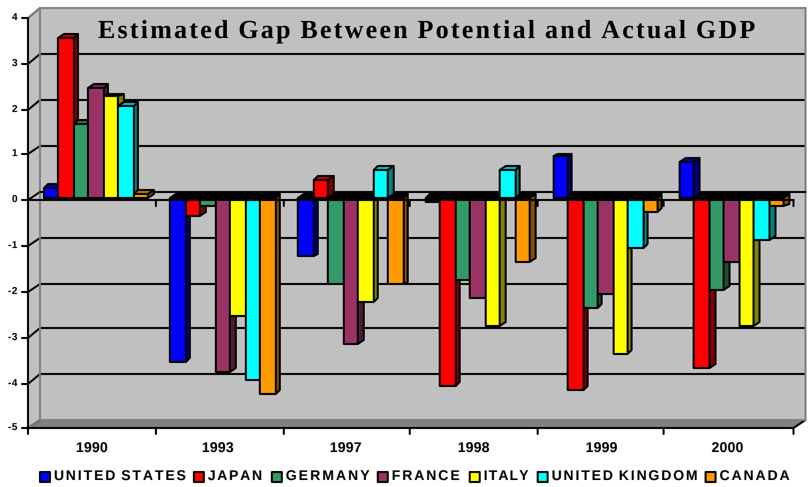


Source: Bloomberg's

Central banks have been taking back their precautionary easing moves and long-term interest rates have begun a retreat from their lows. Equity markets have so far have held up fairly well despite the rising cost of credit; however, analysts remain quite concerned about the possibility of a sharp correction if interest rates move up markedly. Although the U.S. market is viewed as the most vulnerable, stocks in a number of countries are at historically high levels relative to earnings.

The upside on interest rates may be tempered, however, by the absence of strong underlying global inflationary pressure. There are concerns in the United States about the sustained domestic expansion straining the labor market, but most of Europe has been growing below potential for much of the decade. Japan has performed even more poorly. The resulting excess productive capacity in foreign industrialized countries should restrain price pressure, especially for traded goods. However, the United States may experience rising import prices if foreign exchange rates move adversely.

Overseas Economies Have Room to Grow

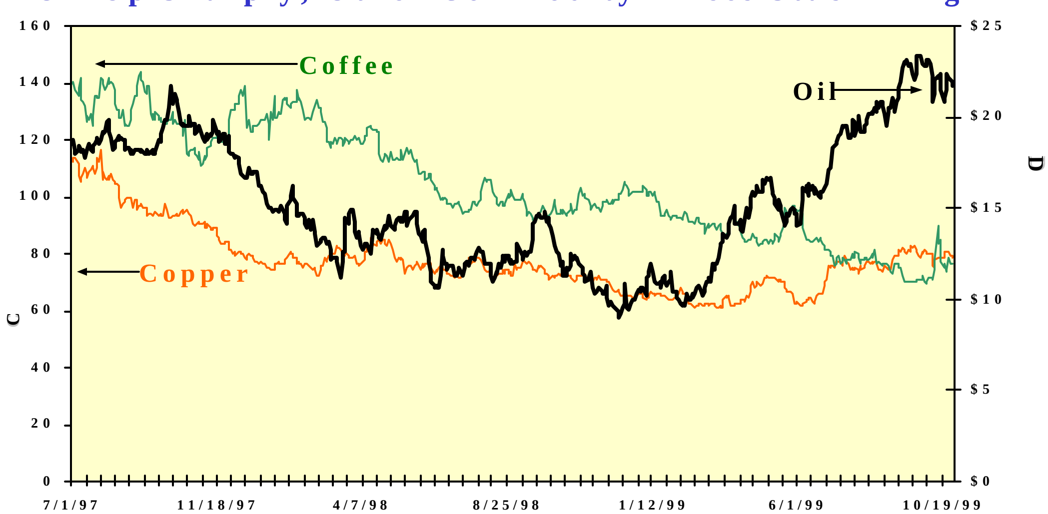


Source: IMF

Commodity Prices

The increase in global demand has contributed to a firming in the prices for some raw materials, in many cases from historically low levels. But not all commodities have recovered. Oil prices doubled over the January to November period; however, a significant factor in the rise was the action by the Organization of the Petroleum Exporting

Oil Up Sharply; Other Commodity Prices Stabilizing



Source: Bloomberg's

Countries (OPEC) to cut production. The petroleum price increases to date will generate sizable transfers from importers to exporters, but do not appear to be a major threat to inflation or to abort the expansion.

For producers of copper, wheat, coffee, and other major commodities, the news has not been so positive. Although the recoveries in Europe and Asia will provide some support, high inventory levels look likely to limit the room for price increases in the medium term. In some cases, the stock accumulation has resulted from efforts by raw materials suppliers to offset the revenue effect from falling prices by increasing production. In Chile, the world's largest exporter of copper, state-owned producers increased output by 21 percent. For other products, such as Brazilian coffee, unusually good harvests contributed to the buildup in inventories.

Increasing Commodity Stocks will Offset Increases In Demand to Keep Most Commodity Prices at Bay

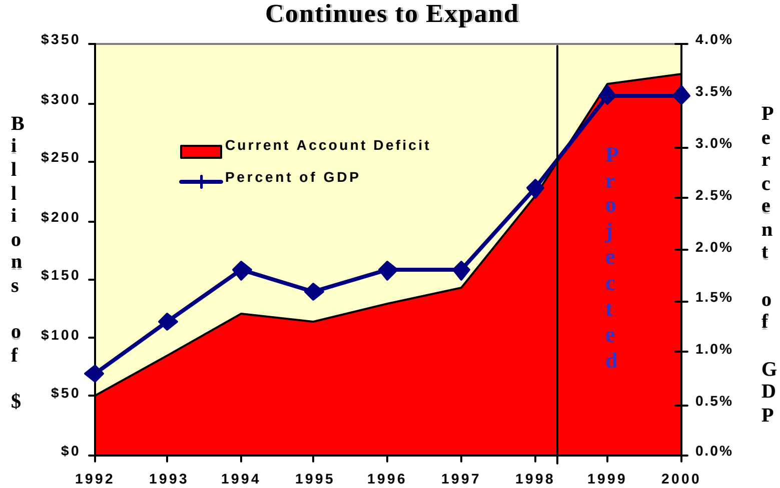
Stock of:	1997	1998	1999	2000	2001
Coffee	43.1	47.6	51.5	65.5	78.1
Copper	898	1260	1545	1740	1715
Oil	2648	2717	2600	2550	2760
Sugar	42.2	44.3	49.3	54.3	53.7

Source: EIU Viewswire
Notes: Coffee - m 60-kg bags with 12 month period ending in September;
Oil - m b/d for total OECD stocks; copper is refined - '000 tonnes;
Sugar - m tonnes with 12 month period ending August 31st.

Current Account Imbalances

One consequence of the continued expansion in the United States is further growth in the current account deficit, which the IMF (and most analysts) project will exceed $300 billion this year and $330 billion in 2000. The pickup abroad increases demand for U.S. exports but, by itself, is inadequate to stem the growing red ink. The deficit will be even larger if the domestic economy does not decelerate as expected. Slowing in the United States will facilitate the transfer of some production from the domestic market to exports. The deficit is now approaching its mid 1980's highs relative to GDP and there are increasing concerns about the sustainability of international financing. Given the size of deficit, any deterioration in the relative attractiveness of U.S. assets could produce significant volatility in foreign exchange and interest rate markets.

Despite Stronger Foreign Growth U.S. Current Account Deficit Continues to Expand

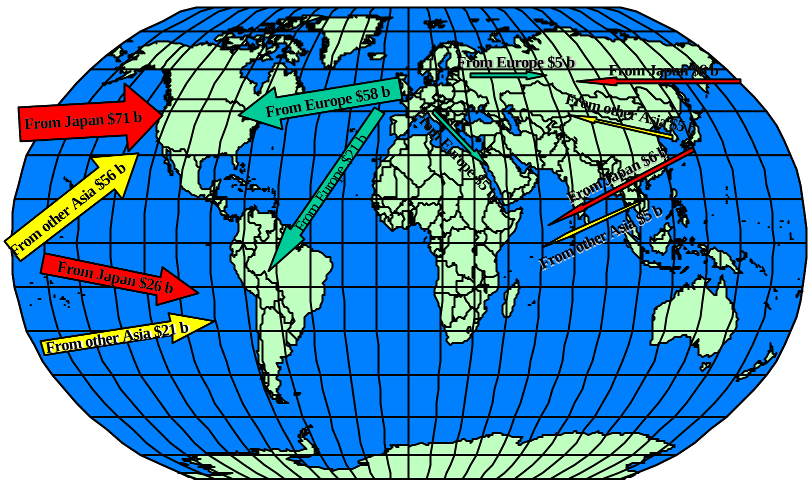


Source: IMF

Financing of the U.S. current account deficit dominates global balance of payments flows. Latin America, Africa, the former Soviet Union, and the Middle East are all net recipients of funds but on a much smaller scale than the United States. The bulk of the funds are supplied from Asia, although Europe is also an important source. With much of the rest of world growing slowly, the United States has not faced significant competition for funding.

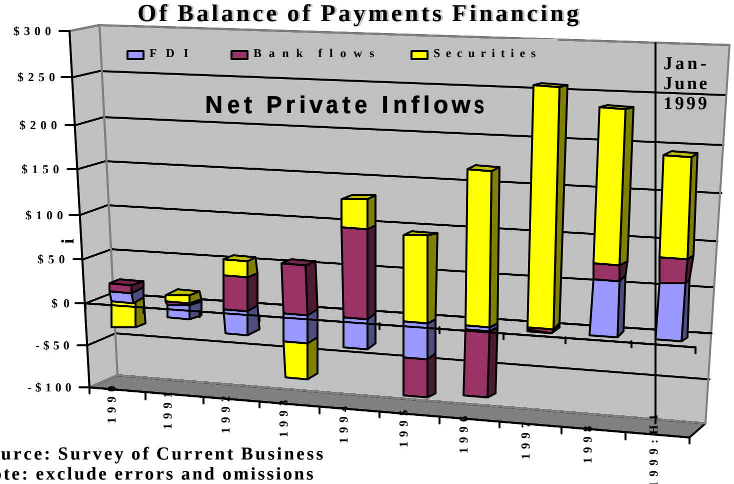
In the last few years, securities transactions have come to be the most critical element in financing the U.S. balance of payments. Bank flows can be important components, but in the last two years have been relatively small. So far, there is little evidence of a change in foreign investment interest. Foreign demand for U.S. financial assets has continued to be quite strong through the first eight months of this year.

World Net Capital Flows



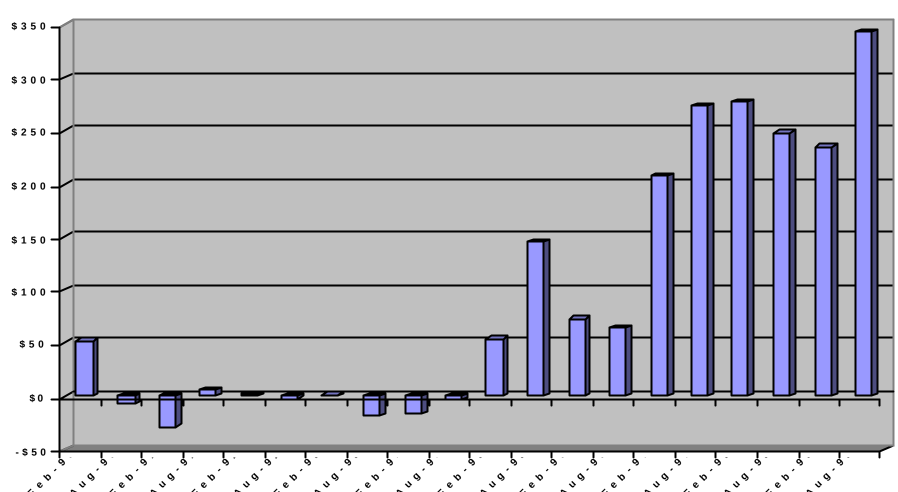
Amounts shown are 1998 net flows
Source: IMF

Foreign Net Purchases of U.S. Securities Key Component Of Balance of Payments Financing



Source: Survey of Current Business
Note: exclude errors and omissions

Net Private Foreign Purchases of U.S. Securities

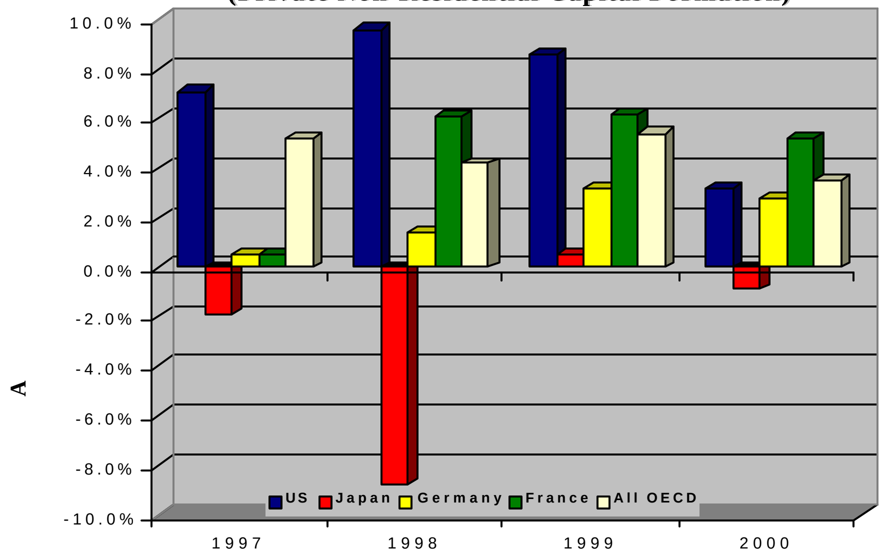


For 12 months ending
Source: Treasury International Capital Reports

A key factor in the ability of the United States to attract large-scale capital inflows has been the prospect for a better return on investment. Sluggish growth in a number of major foreign industrialized countries over the last few years has produced a climate with relatively poor prospects for return on new capital expenditures. Consequently, private sector investment spending has been weak in many other countries. In contrast, the more rapidly expanding U.S. economy has offered better opportunities and investment has been booming. The shift in the locus of growth in 2000, towards greater strength in Europe, could modify this dynamic and reduce the U. S. advantage.

Investment Prospects Have Been More Attractive in the U.S.

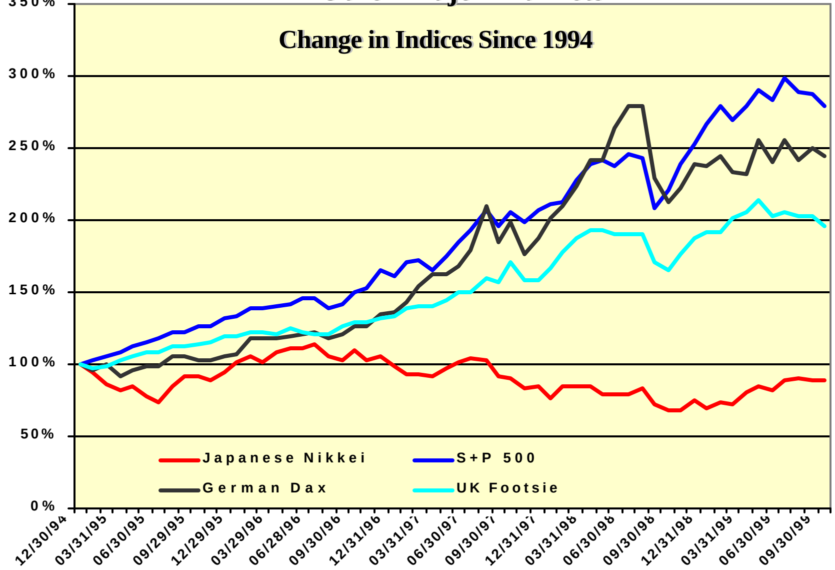
(Private Non-Residential Capital Formation)



Source: OECD

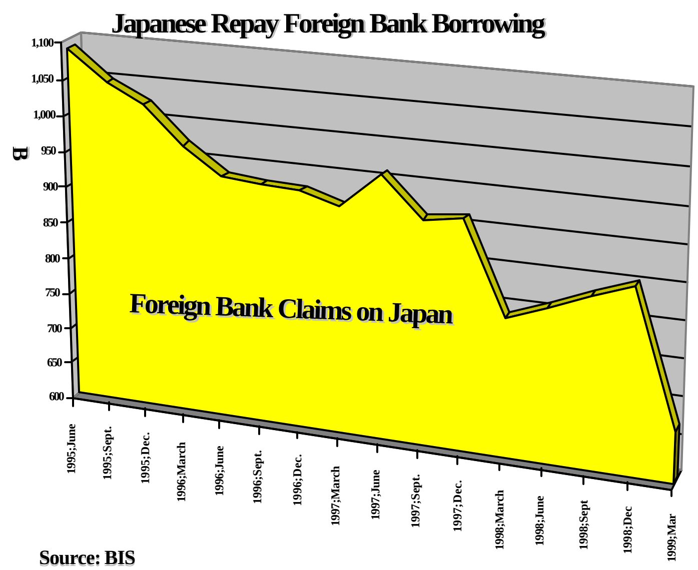
The more favorable U.S. climate has been manifested in a number of ways. Returns on equity have been stronger over the period, especially in comparison to Japan, where stocks have performed particularly dismally. Recent large-scale merger activity stimulated by the introduction of the single currency in Europe, the euro, has provided a boost to equities in euro zone countries.

U.S. Equities Have Outperformed Other Major Markets

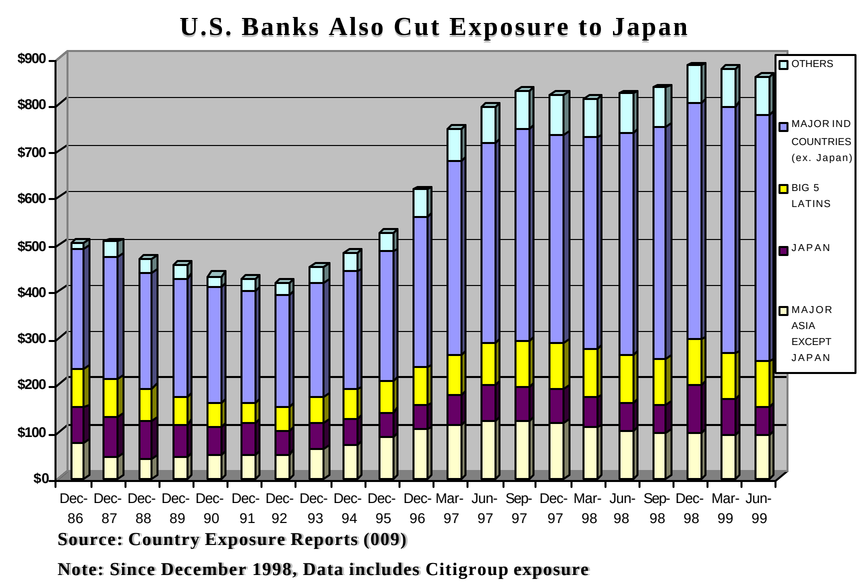


Source: Bloomberg

International Banking Flows



Despite some retrenchment by Japanese financial institutions in recent years, flows from the country remain critical in the international movement of funds. Japan has by far the largest current account surplus, which is expected to hit $117 billion in 1999. (France is a distant second at $34 billion.) As a result, significant shifts in Japanese capital outflows are likely to have important implications for international financial markets. Banking flows have traditionally been an important part of the mix. Since 1995, over $400 billion in foreign bank claims on Japan have been paid down. (This is consistent with the trend, noted in the June "Global Report", for Japanese bank branches in the United States to replace a portion of their local liabilities with claims on the head office.) These repayments are approximately equal to the country's aggregate current account surplus over the period. Given that outstanding foreign bank claims on Japan had fallen to $650 billion as of March 1999, the pace of repayment may slow. If so, this implies that the surplus will need to find another channel for recycling and the process may create pressures in financial markets.



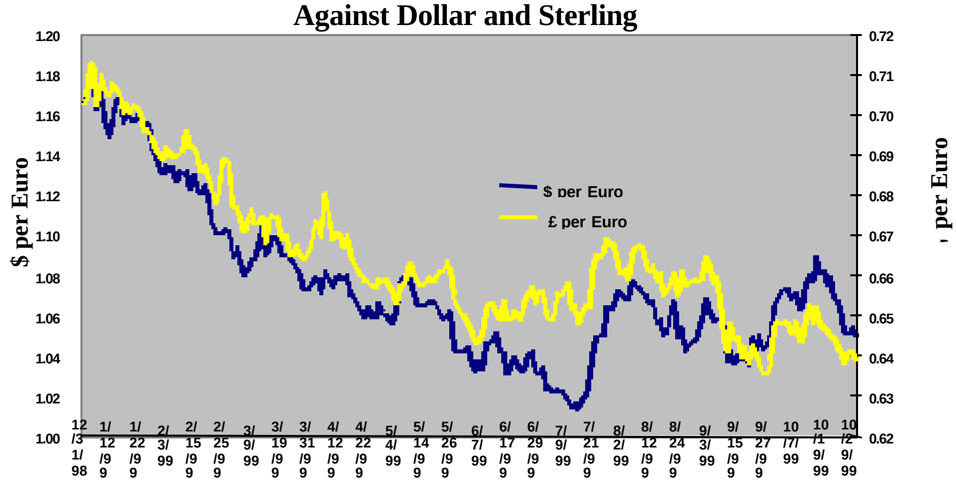
U.S. banks continue to be cautious about their foreign exposure since the outbreak of the Asian crisis. Consistent with the trend noted above, they have been running down their claims on Japan for some time. (The fourth quarter 1998 increase largely represents the addition of the expanded Citigroup members to the reporting universe.) Exposure to the developed world has held relatively steady so far this year.

Review of Regional Developments

Western Europe: Economic Developments

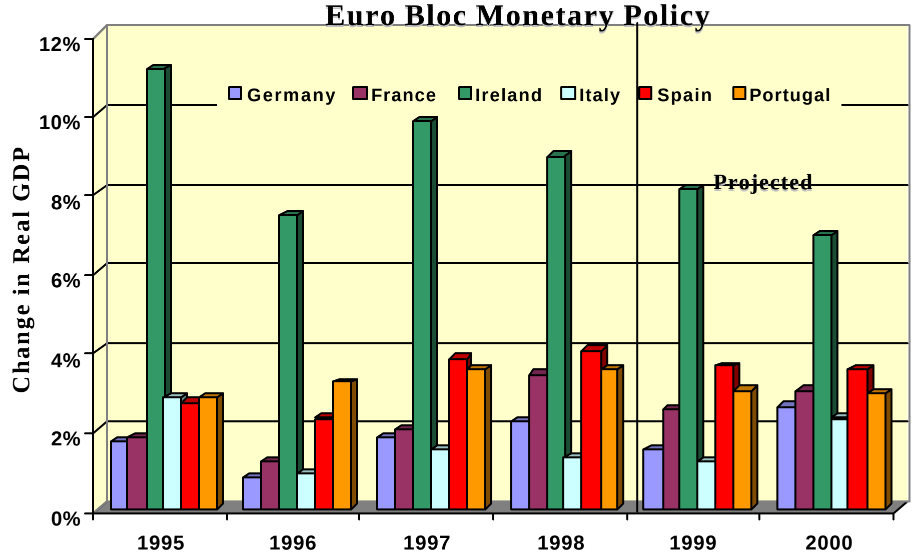
Signs of more robust growth in Europe arrived as hoped this summer, relieving pressure on the euro. Up to that point, there had been concern that the fledgling currency might drop through parity against the dollar. This could have triggered large-scale euro sales and possibly induced a premature tightening of monetary policy by the European Central Bank (ECB), which had not yet established its credentials with the market. Improvement in the trade sector was an important factor in the pickup. Exports benefited from the competitive gains accompanying the euro's weakness and the revival of economic activity in Eastern Europe, Asia, and Latin America. Businesses also began to rebuild inventories run down in the previous year adding to the positive momentum. This has, in turn, led to a general improvement in sentiment and a firming of consumption. In a reflection of its confidence in the stability of the recovery, the ECB raised interest rates by 50 basis points in November thereby reversing an April cut of the same amount.

Euro Off Lows But Well Down From Initial Values Against Dollar and Sterling



Source: Bloomberg

Large Differences in Growth Complicate Euro Bloc Monetary Policy

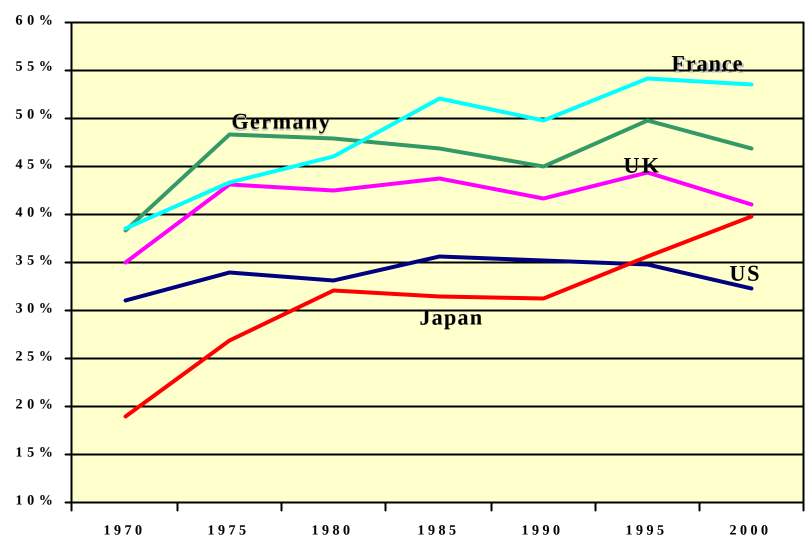


Source: Consensus Economics

Despite the improved environment, the euro zone members face a number of important structural problems. There continue to be large differences in the relative rates of economic activity in the bloc, which creates tension in the system.

Some of the smaller countries, most notably Ireland, have experienced very strong expansion over a number of years. In part, this is due to the benefits that accrued from the decline of domestic interest rates to German levels. The sustained growth has sharply reduced unemployment (in Ireland to just over 5 percent from 10.3 percent in 1997), and produced a surge in personal income. The new wealth coupled with cheaper financing has led to sharp gains in asset prices, particularly real estate. (Residential mortgage lending was up 23 percent this year through July in Ireland.) Although in smaller countries, like Ireland, there were concerns that some of the rise could be speculative, and that a sizable correction could follow, local governments have no separate monetary policy authority. Thus, they are unable to tighten credit to take the froth off the market (and are left with more crude fiscal policy instruments). In contrast, growth in the larger countries has remained sluggish. They have significant excess capacity and face no price pressures. The European Central Bank faces the challenge of balancing these conflicting circumstances. (Compared to the United States, there is much less mobility of labor in response to sizable and protracted differences in growth in Europe.)

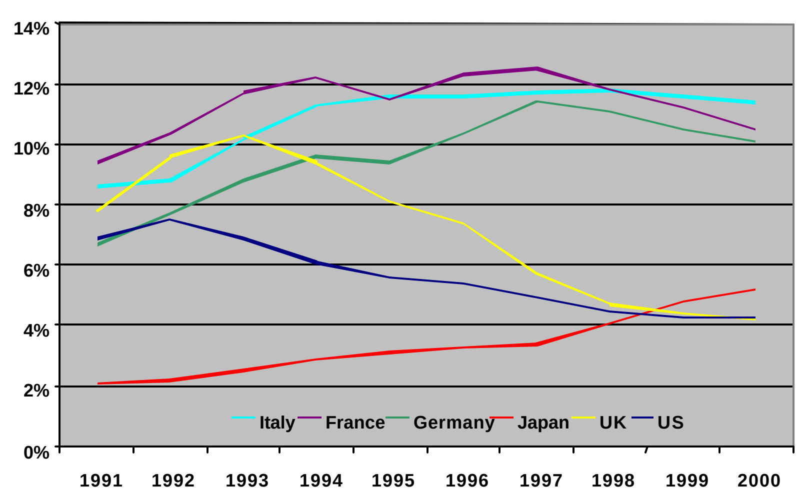
Government Outlays as a Percent of GDP



Source: IMF

Governments are also struggling to deal with the legacy of past policy decisions. In particular, there is widespread agreement among policy makers that, despite some retrenchment made to qualify for the single currency criteria, the size of the public sector remains too large in most of the euro zone. In particular, the tax and expenditure pattern is felt to be providing the wrong incentives to business and

Unemployment Remains Stubbornly High in Euro Zone



Source: Consensus Economics

labor and restraining development of the private sector.

Unemployment rates remain in double digits for many of the euro zone countries. A portion of this problem is widely believed to be related to generous transfer payments, which are viewed as critically in need of reform. The more positive growth performance of the United States, with its considerably smaller government sector as illustrated in the "government Outlays" chart, is viewed as an important example. Governments are moving to adopt a more market-oriented approach. However, the pace of change differs considerably among the countries and there remains important political resistance. Economic growth in the United Kingdom, which is not in the single currency bloc, has been surprisingly strong due exclusively to very robust domestic demand. The appreciation of sterling against the euro has reduced the country's international competitiveness and the external sector has been a huge drag. Net exports subtracted over 2 percent from GDP in 1998 and almost that much this year. A better balance is expected in 2000. The Bank of England has moved to tighten monetary policy to dampen domestic spending and a pickup in activity on the continent should increase interest in British products. The London financial sector, which is an important contributor to the overall economy, has not been damaged by the introduction of the euro.

BANKING IN THE EUROPEAN UNION
A Rapidly Changing Environment

Summary

Merger and acquisition (M&A) activity is booming in Europe. The total value of deals between companies within the European Union (EU) for the first four months of 1999 exceeded $400 billion and equals the total for all of 1998. Transactions between EU and non-EU companies reached almost $200 billion, in line with 1998 totals.[1] Consolidation in the financial services industry contributed significantly to these totals.[2]

The M&A activity in the financial services sector in the EU, where banks are seen as "national treasures," has raised concerns of increasing nationalism in certain member states. The European Commission (EC) and national supervisors are both charged with reviewing possible competition issues associated with mergers and in one instance, a national supervisor's decision is being challenged by the EC in the EC Court of Justice. Further industry consolidation, including determining the ultimate control of national markets in the EU and future cross-border acquisitions, will be affected by the decisions made by the EC Competition Commission, the EC Court of Justice, and politicians in the member states.

Merger activity in Europe is expected to continue for the foreseeable future. Hostile and unsolicited mergers are becoming more and more prevalent while mergers outside the banking area will also affect banking. The ease of cross-border mergers in nonbanking sectors will eventually spread to the banking sector.

Issues to Watch

- Cross-border bank mergers within the EU and between EU and non-EU financial institutions
- Impact of cross-shareholding on future bank merger activity
- Changes in European bank supervisory strategies resulting from merger activity
- Weakening of banking relationships resulting from firms' expanded access to capital markets
- Development of the e-commerce regulatory framework in Europe

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[1] *Global*, Vol. 2, No. 2, Oct/Nov. 1999, Deloitte & Touche LLP, NY, NY, pages 4-5. These figures reflect all mergers, not just financial sector mergers.

[2] Since 1985, M&A activity has been increasing in Europe with the number of independent banks declining from 13,800 to 9,800 as of third quarter 1998 (FRB-Chicago Sept. 1998 Netherlands Trip Report). The continuing number of mergers in fourth quarter 1998 and through the end of third quarter 1999 has reduced the number further as second and third generation mergers are occurring among banks that were themselves the result of prior mergers.

Issues Raised by Bank Mergers

Mergers and Acquisitions (M&A's) in the financial services industry are facilitated by the universal banking license. Financial service entities in Europe enjoy a complex web of strategic alliances and inter-company cross-share holdings. These alliances and cross-share holdings are fueling the industry's consolidation. Twenty-six of the largest 50 banks in the world are headquartered in the EU[3] (See Appendix -- Table 1) and these institutions have insurance companies, other banks and leading commercial corporations as major share holders. As M&A activity continues across Europe, banks and supervisors alike are dealing with a host of issues, including:

- *Increased nationalism*. Big local banks have a greater chance at being European (and even global) players, thereby enhancing the political position of a member state's finance minister and its supervisor. Politicians are increasingly playing a role in merger decisions involving a country's largest banks. Smaller countries' supervisors and competition authorities may willingly accept higher levels of banking concentration in their home market to create large institutions able to compete in the EU and internationally.

- *Supervision of these emerging conglomerates (by whom and how).* There are increasing questions as to whether a "lead" regulator needs to be identified and whether some of these new conglomerates could be considered "too big to fail."

- *Regulatory hurdles (EC Competition Commission vs. national supervisors).* Language barriers, independent tax structures, commercial code, and legal and regulatory differences may inhibit cross-border mergers.

- *Rapid succession merger and acquisition activities and greater operational risk*. Second- and third-generation mergers are occurring before prior acquisitions have been fully integrated.

- *Post-merger difficulties.* A number of issues can arise following merger activity, including: higher risk profiles for the resulting banking group and the possibility of increased earnings volatility; declining capital ratios; heavy unforeseen losses; declining earnings due to high administrative costs associated with severance pay packages for senior executives; decline in stock price; and reduced ratings by rating agencies.

- *Favorable regulation and distribution monopolies.* Government guarantees, funding,

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[3] The 15 European Union member countries are: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden and the United Kingdom (UK). Euroland or the euro zone is comprised of the 11 EU member countries that met the Maastricht criteria for entry into the European Monetary Union and converted their currencies ti the euro on January 1, 1999. The four EU members who are NOT part of euroland are Denmark, Greece, Sweden and the UK. ***NOTE***: neither Norway nor Switzerland are member countries.

and/or protection produces unfair competition for privately owned banks in several jurisdictions (France, Germany, and Italy for example). The EC is planning to challenge Germany over controversial financing of its public banks (i.e., the Landesbanks). This challenge could lay the foundation for mergers between private and public sector banks.

C *Expanded access to capital markets by corporations.* Relationship banking may be weakened by this expanded access. Bank lending continues to fuel the M&A activity with acquisitions accounting for 50 percent of the loan market.[4] Although earnings/margins as a result of increased competition for loans and securities are generally expected to be reduced, 23 of the top 30 credit facilitators for European acquisitions are European banks[5] who reap the financial rewards associated with such loan syndications.

The balance of this section elaborates on these issues highlighting the impact of bank merger activity arising from nationalism in some member countries and the general trend of cross-share-holdings among European financial institutions, and developments in bank supervision.

Bank Merger Update

Merger and acquisition activity volume has grown 500 percent since 1992. Factors contributing to the merger mania include:

- Restructuring to avoid or combat hostile bids;
- Restructuring of banking and insurance sectors in key countries;
- Privatization of government owned banks;
- Improving and favorable economic climate;
- A greater depth, breadth, liquidity and diversity in the European capital markets; and,
- Desire for better earnings and market penetration.

There is increased pressure on European banks to build market share across the eurozone and a desire to be well positioned in the core euroland countries (ie., Germany, Italy, and France). However, bank consolidation in certain countries still lags. The top banks in the various member states control anywhere from 14 percent to 60 percent of their local markets. Banking consolidation in the Nordic countries is further ahead than in the core euroland countries. However, the flurry of activity in France, Italy, and Spain in recent months is rapidly creating market leaders with increased national shares of loans and deposits. The German market has undergone little significant consolidation. This is partly due to its slower economic rebound and its government-backed Landesbank and savings bank sectors. The existence of these government-funded and -owned banks hinders industry consolidation and has forced Germany's

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[4] Loan Pricing Corporation, *Gold Sheets*, Oct. 18, 1999, page 1.

[5] Ibid., page 21.

leading banks to seek partners outside their local market (such as Deutsche Bank's acquisition of Bankers Trust and current talks between Banque Nationale de Paris and Dresdner).

Nationalism and Banking Industry Consolidation

Banking industry consolidation has revealed latent "nationalism" in the various member countries as evidenced by encouragement of mergers among a country's largest banks, denial of proposals involving foreign acquirers, and blocked mergers involving hostile takeovers. Bank merger announcements in 1999 have involved more hostile takeovers and behind-the-scenes involvement of national governments and supervisors. The role of governments, supervisors, and the EC Competition Commission are shaping the future direction of European consolidation. While some announcements earlier in the year fell by the wayside, others have taken their place (See Appendix -- Table 2).

- In France, the March announcement by Banque Nationale de Paris (BNP) to mount a hostile takeover bid for both Paribas and Société Générale, themselves seeking a friendly merger with each other, prompted the French authorities to encourage all three managements to come to an amicable solution. A three-way merger would have created the world's largest bank, reducing the possibility that France's largest banks would be vulnerable to foreign takeovers. BNP's failure to obtain sufficient shares of Société Générale freed the latter bank to go off on its own to seek another partner on friendlier terms.

- In Italy, two different proposed mergers in March involving Italy's four largest banks were blocked by the Italian Central Bank who determined the proposals were hostile. The Italian Central Bank has stated it will not approve hostile mergers since it feels such mergers have increased risks associated with integration. At the time, the EC questioned the Central Bank's action as impeding free market transactions, but did not pursue the issue because all banks involved were Italian.

- Recently, Italy's largest bank, San Paolo-IMI, bid for INA, a leading Italian insurance company. This proposed merger would have created Italy's first major *bancassurance* conglomerate. The governor of the Central Bank does not feel banking and insurance should be together under one conglomerate and worked behind the scenes to help structure a transaction that would keep insurance and banking separate.

- Portugal's denial of Spain's Banco Santander Central Hispano's (BSCH) bid for control of Mundial Confianca, an insurance company that controls Portugal's third largest financial group, prompted intervention by the European Commission's Competition Commission. The EC ruled that the denial of the BSCH bid was illegal under EU competition law, appeared to cloak national protectionism in the guise of prudential concerns, and must be rescinded by Portugal's Finance Minister. The EC rules on freedom of establishment and free movement of capital were also at issue. Portugal's finance minister refused to revoke the denial and the case was referred to the European Court of Justice. Meanwhile, BSCH restructured its bid for Mundial Confianca, which received the approval of Portugal's finance minister. The

European Court of Justice has not yet ruled on the case and it is hoped that approval of the restructured bid will negate the referral to the court. This was the first test case involving European banking consolidation and could result in heavy fines to Portugal if the Court of Justice rules against it.

The EC has its own "nationalistic" tendencies to overcome as it looks toward the future, particularly in the area of e-commerce. E-commerce will play a significant role in banking and cross-border consolidation in the future. Accordingly, the EC is working to amend some existing directives and develop new ones that will better identify and harmonize the regulatory framework surrounding e-commerce. One of the proposed directives addresses the liabilities of Internet service providers; includes clauses removing barriers to electronic contracts; and requires that online traders state where they are physically based. A failure to create a single legal framework for e-commerce in the EU could reduce the growth prospects in this area.

Cross-shareholdings and Merger Proposals

Cross-shareholdings among financial institutions can have a direct impact on merger proposals. It is not unusual for companies to own strategic holdings in numerous financial companies and for those companies to also own stakes in their shareholders and shareholders' competitors. The impact of these cross-shareholdings should not be underestimated. A merger, for example, of Italy's two largest banks would require divestiture of equity holdings in several industries, such as energy and telecommunications, since a merger would result in industry concentrations beyond those allowed by the EC.

One important issue raised by cross-shareholding is the possibility that a major shareholder may step in to preserve its own interests over those of the bank. This is noteworthy since many banks have major insurers as shareholders and they are direct competitors for financial services. In fact, 10 of the world's 20 largest insurers are in the EU (See Appendix -Table 3) and many own major stakes in European banks. While cross-border acquisitions have been primarily limited to strategic alliances, cross-sector stakes have become part of banking in Europe for many years. Linking the insurance products with the branching network of some of the EU's largest banks significantly enhances the distribution network for insurance companies.

Examples of cross-shareholdings include:

- The major insurance conglomerate in Germany, Allianz, owns stakes in Germany's three largest banks, Dresdner, HypoVereinsbank, and Deutsche Bank. Allianz is a major factor in possible mergers affecting Dresdner and HypoVereinsbank because it has a controlling ownership position. It is also a major financial conglomerate vying with Deutsche Bank to be Germany's leading financial entity.

- AXA (France's largest insurer) and Italy's Mediobanca and Banca Commerciale Italiana, tendered their Paribas shares to Banque Nationale de Paris in the recent merger battle with Société Générale and may have influenced other core shareholders to follow. Had these shareholders tendered their shares instead to Société Générale, it is possible that BNP would not have been successful in its hostile bid for Paribas.

- In Italy, the bid by San Paolo-IMI for INA prompted a hostile counter-bid by Italy's leading insurer, Generali. The result was a compromise worked out between San Paolo-IMI and Generali.

Supervision Update: The New European Banking Environment

European banking supervisors are facing a new environment, one where the friendly gentlemen's agreements of the past have given way to hostile bids for major competitors, and foreign conglomerates are taking stakes in their country's largest banks. Some of the issues raised by this new environment are:

- Questions as to who will be the "lead" supervisor for proposed cross-border conglomerates have caused some deals to be canceled when regulatory approvals could not be guaranteed. The eventual supervisory arrangements for the first cross-border merger between a euroland and non-euroland financial institution could set a precedent for future deals and involve tricky negotiations between multiple supervisors. Supervisors are not yet willing to cede supervisory control of their country's leading bank to a foreign supervisor.

- As more and more linkages emerge in the EU, the risks are increased that transactions can escape supervisory scrutiny or slip through supervisory gaps. This is particularly relevant since operational risks have increased significantly in European banks involved in mergers and acquisitions activity. New mergers are occurring even before institutions have successfully integrated operations, personnel, and strategies from previous acquisitions. Due to the multitude of acquisitions in the last few years, politicians are scrutinizing their supervisory structures to ensure they are up to the task of supervising the ever-increasing number of large, complex financial institutions.

- In some countries, proposals for shifting supervision from one authority to another are being considered. Contrary to a general trend of shifting supervision out of the central banks, the Austrian government is considering shifting banking supervision from the Ministry of Finance to a separate entity under the Austrian Central Bank.

- Supervisors have renewed contacts in member countries and in some instances, conduct joint inspections for some cross-border entities.

The recent money-laundering scandal involving Bank of New York has prompted the EU leaders to attempt to harmonize their legislation on money laundering within the EU, including tracing, freezing of accounts, and confiscation of funds. The EU spoke out against money laundering at its special summit on justice and home affairs in mid-October. Leaders have agreed to a 10-point plan to crack down on organized crime among other EU issues. In the UK, the Treasury has revised its all-encompassing super-regulator regulation. Initially, it was thought that the

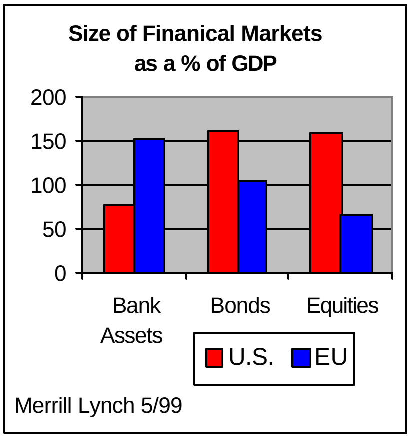
Financial Services Authority (FSA) would be tasked with the oversight of all 13,000 legal and accountancy firms involved in financial services in addition to the banks, insurance, and securities firms. Instead, full regulation from the FSA will apply only to approximately 2,000 firms engaged in the "mainstream" financial services business.

- The framework exists in the EU for sharing of supervisory information with members of the union. A less definite framework existed for sharing information between the EU and the United States until June of this year when a framework agreement was signed between the EC and the OCC and Federal Reserve Board. The agreement sets forth the framework for establishing separate bilateral agreements with EU member states. Such agreements help close the supervisory gaps that may occur.

- In France, recent changes in the secrecy law enable on-site supervision of subsidiaries of credit institutions within France. The law also allows for implementation of a legal framework for the exchange of information between supervisory authorities. Such steps are necessary if supervisors are to ensure prudential supervision of cross-border entities.

Western Europe: Capital Markets Developments

A number of significant changes are occurring in the Western European capital markets. Most of the changes started well in advance of the introduction of the euro on January 1, 1999. However, the euro has served as a catalyst to push forward transformation of the markets. Other important factors effecting change include technological developments and globalization. Deep structural changes are expected to continue over the medium term. As capital markets participants, banks will be affected by these changes. Relative to the United States, European banks play a much greater role as financial intermediaries than the securities markets.



Issues to Watch

- The effect of changes in the European Union (EU) capital markets on banks, for example: disintermediation as borrowers and depositors may elect to fund or invest through the securities markets, with an attendant loss of business for small and regional sized financial intermediaries and gain of business for larger investment houses and universal banks.

- The effects of technology on the structure and efficiency of the capital markets, such as lowering transaction costs, increasing turnover and liquidity, fragmentation or concentration of financial intermediaries, and continued growth in the over-the-counter derivatives market.

- Timely implementation of the European Commission's Action Plan to substantially enhance the efficiency of Europe's financial markets, by removing obstacles to EU-wide use of prospectuses, improving legal certainty for EU-wide use of collateral, easing EU-wide tax distortions on life and pension products, and addressing EU-wide accounting disparities.

- Private sector efforts to enhance market efficiency and create a single market, such as the creation of a single European settlement and clearing house and increased linkages between markets.

- Trends creating changes in the demand and supply of securities, such as the level of privatizations, pension reform schemes that result in increased demand and the lifting of restrictions on how pension assets can be invested, and the level of mergers and acquisitions (M&A) activity.

Bond Markets

Among the most visible signs of change are developments in the bond markets. Conversion to the euro meant that currency risk was eliminated among the 11 European countries that comprise the euro-zone. This alone has radically changed the landscape for both investors and issuers. An increasingly pan-European investor base, a much larger issuance market, and a broader spectrum of issuers are accelerating the development of the bond market.

One of the noteworthy developments in 1999 is the increased activity in the corporate bond market. By one estimate, corporate issuances have increased four times over the same period last year, albeit from low levels. Increases occurred not only in volumes but in the size of deals, which is enhancing market liquidity. For example, last July Tecnost raised approximately EUR 6.25 bil (USD 6.6 bil) in the international bond markets.[1] Tecnost is the vehicle through which Olivetti carried out its takeover of Telecom Italia.

Euro Zone Credit Issuance By Sector	YTD 10/7/99 EUR bil	% Change Same Period '98
Banks/Finance	176	87 %
Corporates	98	401
Supranational	25	58
Sov/Govt/Auth	13	-57
Utilities	21	84
TOTAL	330	93

Source: DeutscheBank

Developments in both the demand and supply side are stimulating bond market activity. On the demand side, the investor profile is changing. The investor base has broadened to pan-European from a national basis, as insurance companies and fund managers diversify away from their home country markets. Also, European investors are looking for better yields than governments now offer. Investors have been moving down the credit curve in this attempt. For example, in 1995, 15 percent of new issues in the euro's predecessor currencies were rated "single A", versus 38 percent so far in 1999.[2]

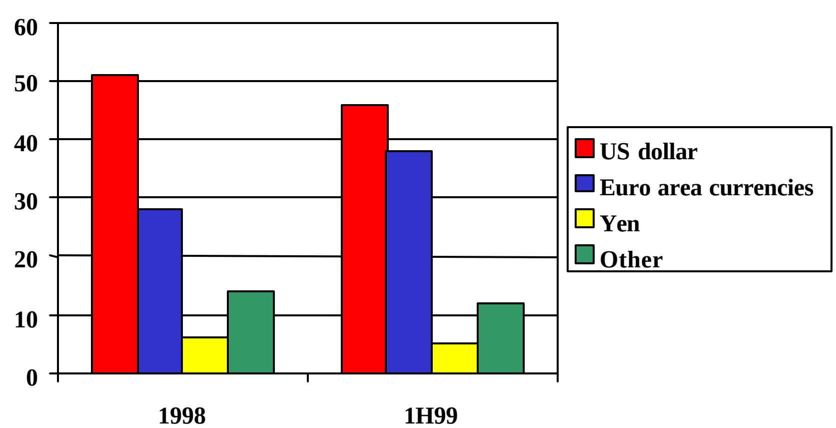
On the supply side, a primary driver of the increase has been a need to finance Europe's M&A activity. M&A volumes have been almost as high for the first half of 1999 as for the whole of 1998, itself a record year. The deals have been financed in the capital markets.[3]

The euro zone's corporate bond market is very small. While the market is small, many view the increasing trend toward corporate bond issuances as a structural change that will be a source of disintermediation to European banks. Also, banks, as the traditional funding source for corporates, are increasingly reluctant to lend at uneconomically low rates in part due to shareholder pressure to improve earnings. This is contributing to predictions that the corporate bond market will expand at the expense of some banks, as European issuers are starting to have a wider array of financing options. While a bank's corporate loan business could be transferred to its investment banking unit, this is not a given especially in light of the intensely competitive environment. Banks involved in underwriting bond issuances are experiencing fierce and increasing competition from outside their traditional home country markets.

Expanded corporate access to the capital markets is expected by some to weaken relationship banking and bring increasing competition to the pricing of loans and securities. Large investment banks and universal banks are expected to benefit at the expense of smaller and regionally focused financial intermediaries. Regarding U.S. banks, fears that they would lose out in European business opportunities have been largely unfounded. U.S. investment banks are seen as major competitors to their European counterparts.

In another supply-side trend, EU governments are borrowing less than they used to due in part to the need to abide by the Maastricht Treaty limits on public debt. Governments have been by far the largest category of bond issuer in the euro zone. Also, most observers believe that the trend of liquidity in the government bond markets being driven to the larger countries will continue. Observers cite the sharp downturn in the turnover of smaller government bond markets in recent years as evidence. Explanations for the trend vary, including the reduction of market-making by domestic banks, investors in the smaller markets diversifying away from their domestic debt to larger markets, and lower credit ratings of some smaller countries.

International Bond and Note Issuance
Percent of Total by Major Currency
Source: BIS



In other related bond market trends, many market observers point to the large number of international bonds issued in euros in 1999 as a clear success for Europe's monetary union. The euro denominated bond market has been developing fast, reflected by the surge of new issuances in euros compared to 1998 new issue volume in predecessor currencies. (See graph.) The euro's arrival has also affected issuers in countries such as Australia. Until this year, most Australian corporates were excluded from the euromarket due in part to the lack of investor interest in their lower investment grade credit standings. This reflects the shift in appetite for credit risk among European investors.

Equity Markets

While changes in the bond market have been the more telling story, equity market changes are occurring but at a much slower pace. The size of Europe's stock market is small relative to the United States, especially when the United Kingdom is excluded. Thus, there is much potential for growth. Over the past year, there has been an increase in both demand for and supply of new equity issuances. Investment houses have generally switched from country analysis to sector analysis.

On the supply side, new equity issuances through September 1999 approximate the total amount issued for all of 1998. Privatizations accounted for much of the equity issuance and for some of the biggest deals, notably the EUR 10 bil (USD 10.5 bil) secondary sale of Deutsche Telekom.[4] Italy's Enel, a state-owned electric utility company, claims it had the world's largest initial public offering in October of this year after the Italian government announced the sale of EUR 18 bil (USD 19 bil) worth of shares.[5] Additionally, M&A activity is affecting issuance activity, as companies are increasingly looking to increase their capital to pay for acquisitions. Market observers point to volatility in the stock markets as a reason why volumes have not been higher.

On the demand side, there have been shifts in investor demand for stocks across national borders. Reportedly, the retail investor has been playing an increasing role in the market. The retail investor is credited with being the driving force behind the success of Germany's small capitalization stock market, the Neuer Market, which specializes in listing high-tech stocks. The Neuer Market has attracted 105 new listings in the past nine months, taking the total number of companies listed since its 1997 launch to 168. The Neuer Market is the biggest member of Euro.NM, Europe's electronic network of growth stock markets.

Structurally, there is growing cooperation between Europe's fragmented stock exchanges. There are at least four different groups with separate plans for some version of a pan-European stock market: Tradepoint Financial Networks, Europe's Easdaq, U.S.'s Nasdaq, and the eight biggest European stock exchanges.[6] A setback occurred recently with the abandonment of plans by the eight biggest European stock exchanges to create a single stock market for trading the shares of Europe's blue chip stocks. A main stumbling point was which exchange's technology to use as a trading platform. Reportedly, an interim solution was reached, with intentions remaining to create a single Europe bourse sometime in the future. Tradepoint plans to offer pan-European equity trading next year. Tradepoint is a London-based electronic stock exchange backed by Reuters' Institnet and a consortium of large investment banks including Merrill Lynch and Morgan Stanley Dean Witter.

Effects of Technology

As evidenced by these plans for a pan-European stock market, technology is having a profound effect on the structural development of European markets. In general, both retail-based online services and intra-dealer systems are increasing rapidly. A number of initiatives involving electronic trading facilities have been announced over the past year. The growth of electronic facilities for the trading of equities and derivatives has also spread to the fixed income market (e.g., EuroMTS). In the area of clearing and settlement, some movement toward consolidation has occurred, but much more is needed. The potential for consolidation in the area of clearing and settlement is highlighted by the existence of more than 30 national clearing systems in Europe compared to three for the U.S. market as a whole.

Supervision and Regulation of the Securities Markets

Supervision and regulation of the securities markets in Europe is not harmonized. There exists no Securities Exchange Commission equivalent on an EU-wide basis. Significant differences between countries exist in areas such as the division between regulation and self-regulation and the powers of the securities market regulator. Companies are subject to different rules by country on accounting, information disclosure, and the treatment of minority shareholders. Two EU directives have attempted to harmonize securities market rules, but market observers say that more harmonization is needed to aid in the creation of a single European market. The European Commission (EC) is attempting to remove the legal and administrative barriers needed to establish an integrated European market for financial services. This is expected to provide for a consistent set of regulations and principles to substantially enhance the efficiency of EU capital markets. The EC's Action Plan is focusing on three areas: wholesale markets, retail markets, and sound supervisory structures.

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[1] Euromoney 9/99

[2] Chase Fixed Income Research 10/99

[3] Euromoney

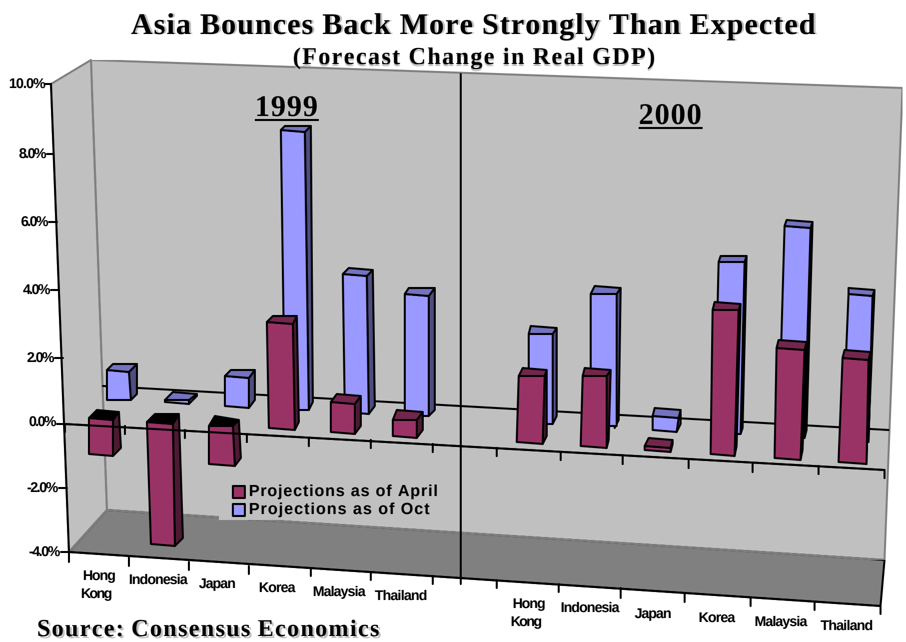
[4] Euromoney

[5] Financial Times 11/99

[6] WSJ Europe 10/99

Asia: Economic Developments

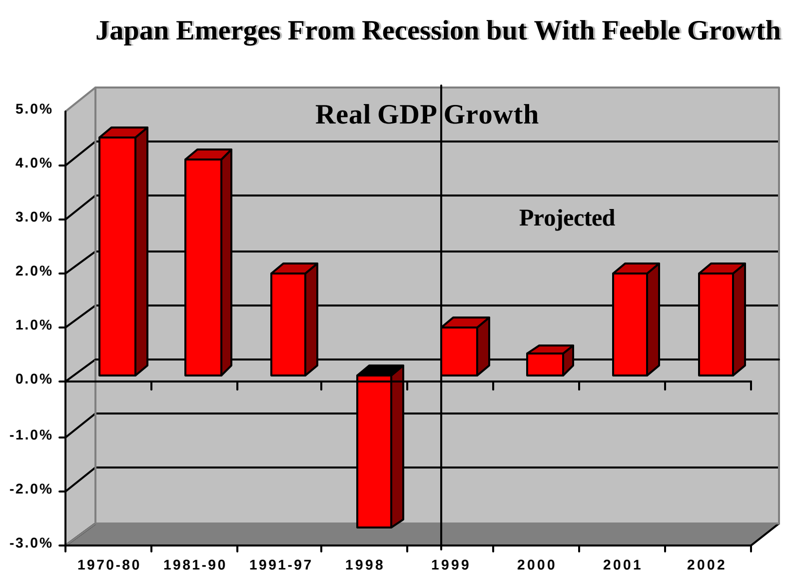
Asian economies have shown surprising strength this year after very poor performances in 1998. The improvement is across the board with Korea being an especially dramatic case. Analysts are now predicting expansion of over 8 percent this year. This is largely attributable to:



Source: Consensus Economics

- Improved external demand (particularly for electronics products);
- Stimulus from increased government spending;
- Rebuilding of inventories (which were run down in the onset of the crisis);
- Stronger consumption, and
- Impact of sustained low interest rates.

However, a number of risks remain. Japan, with the world's second largest economy, is an important economic factor in the region. It is a sizable purchaser of exports from the rest of Asia as well as a major supplier of capital, and technology to the region. Although Japan has pulled out of last year's deep recession, analysts are concerned that structural conditions will limit the economy's strength over the medium term. In particular, the government may be hard pressed to sustain spending levels given the growing debt, which will soon become the largest in the Organization for Economic Cooperaton and Development (OECD), and the strength of the yen may reduce external competitiveness.



Source: Consensus Economics

In addition, unemployment levels continue to rise and prospects for income growth are poor, which could affect consumption.

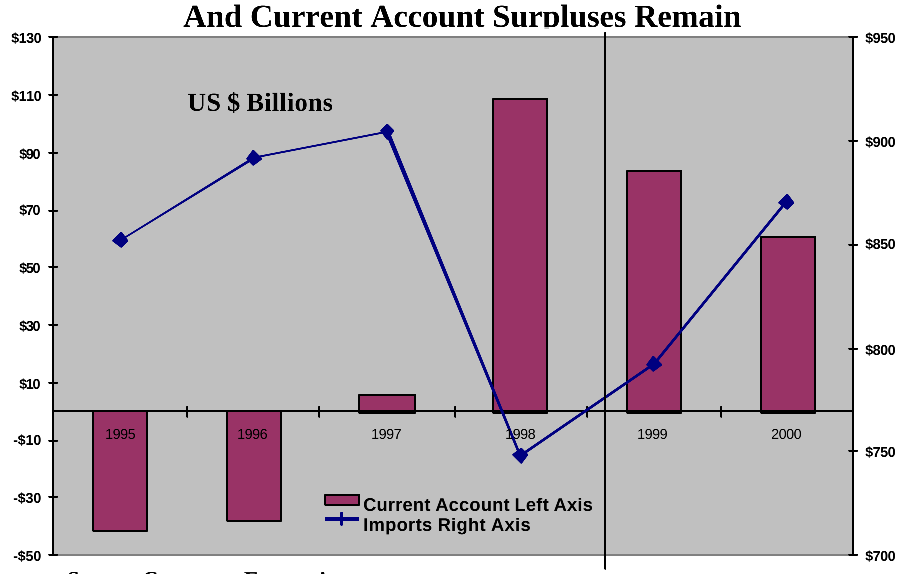
In Japan, and throughout Asia, excess capacity is also a major problem constraining business spending. In the pre-crisis years, investment was the key driver of the economy for many Asian countries. Continuous economic expansion combined with relatively easy financing to produce strong gains in asset values. Unfortunately, the environment also encouraged speculative decisions. When the crisis hit, growth faltered and demand fell. The value of assets dropped sharply. This has affected all sectors of the economy, but is a particularly severe problem for real estate and construction, which remain especially depressed.

	Office Vacancy Rates*	Change in Property Prices **
Shanghai	49.9%	-14.8%
Bangkok	40.0%	-17.3%
Jakarta	22.2%	-13.3%
Kuala Lumpur	21.0%	-18.5%
Seoul	15.0%	0.0%
Hong Kong	14.3%	-29.9%
Singapore	14.2%	-26.2%
Manila	10.9%	-15.9%
Taipei	7.1%	-19.8%
Tokyo	4.7%	-13.8%

Source: JP Morgan
*As of June 99
**Annual change to June 99; for Jakarta in $ terms

One result of the weakness in spending on plant and equipment has been a sharp cutback in imports. During their booming high investment years, emerging Asian countries were major importers of heavy machinery and construction goods. However, the financial crises brought new investment essentially to a halt in the heavily affected countries. This led to a dramatic contraction in demand for foreign products from the region as a whole, despite continued growth in China. Trade and current accounts swung into large surpluses. Although economic activity has strengthened this year in Asia, spending on new plant and equipment continues quite weak and imports remain well below pre-crisis levels. This situation is expected to continue through 2000, and the region will retain a sizable current account surplus.

East Asian Imports Have Not Yet Recovered to Pre-Crisis Levels And Current Account Surpluses Remain



Source: Consensus Economics
Totals for: China, Hong Kong, Indonesia, Korea, Malaysia, Singapore, Thailand and Taiwan (for Hong Kong total of balance on trade and services in lieu of current account)

Asian countries continue to face huge costs associated with bank restructuring. In many cases, this has required the issuance of large volumes of government debt (much of which is swapped for non-performing bank assets). Given that the countries went into the crisis with relatively small stocks of debt outstanding, the fiscal costs are seen as manageable and overall government debt levels will remain controllable (with Indonesia facing more of a challenge in this area than others). However, the costs of servicing the debt will be quite substantial and constrain other government tax and expenditure decisions for some time. The table above gives an indication of the costs to date for bank restructuring. The ultimate costs will be higher.

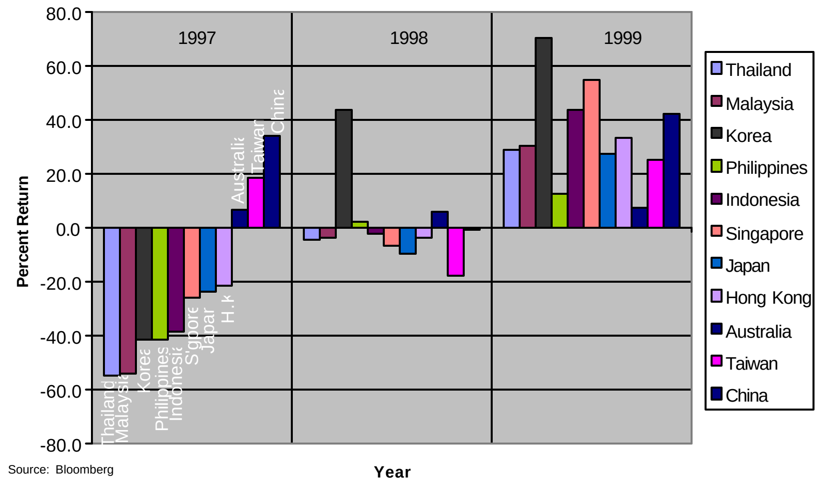
Scheduled Gov't Support for bank Restructuring ($ bil)		As % Of 1998 GDP	Gross Gov't Debt As % of 1998 GDP
Indonesia	$52.50	62.50%	74%
Korea	$61.50	19.20%	70%
Malaysia	$8.20	11.50%	48%
Thailand	$21.60	18.60%	31%
Source: JP Morgan			

Asia: Banking Developments

Summary

Asian financial markets and economies are in recovery. Stock markets rebounded in 1999 after two years of poor performance, and banks have liquidity. The recovery is built on macro-economic adjustments, supported by accommodative monetary and fiscal policy. But, there is concern that the recovery may reduce authorities' enthusiasm for banking and corporate sector restructuring in the region. Corporate sectors remain over-leveraged with poor profitability and excess capacity. Apart from Korea and China, financial institutions are not lending, despite raising significant levels of capital and/or divesting of nonperforming loans to government-established asset management corporations. Banks are the main suppliers of credit in the region and capital markets are not deep enough to compensate for the lack of bank credit. The recovery process will be difficult to sustain unless credit growth resumes.

Chart 1: Stock Market Returns for Asian Countries
1997, 1998, and through August 1999



Further bank and corporate sector restructuring is critical to encourage the resumption of bank credit. However, two major factors impede progress and foster a vicious cycle: banks still lack sufficient capital to restructure corporate loans and the corporate sector is largely unwilling to give up ownership interests or comply with restructuring agreements established by banks as a condition for debt restructuring. Restructuring corporate debt implies debt forgiveness or debt-for-equity swaps, which will adversely affect banks' capital levels. To date, the few corporate debt restructurings that have taken place involve only an extension of terms and/or a reduction in interest rates. Corporate balance sheets remain unaltered and cash flow has not radically improved. There are concerns that restructured loans will become nonperforming in the future, which could lead to new rounds of bank recapitalizations. Unless this vicious cycle is broken, Asian economies may not be able to realize their full growth potential. Moreover, the development of liquid and transparent capital markets is also required to bolster credit availability and lessen corporate dependence on bank financing.

Issues to Watch

- Corporate debt restructuring that involves debt forgiveness and/or debt-for-equity swaps coupled with strategic plans between banks and corporations to improve long-term profitability.

- Banks' ability to raise capital and improve long-term profitability.

- Signs that restructured (refinanced) loans are becoming nonperforming.

- Efforts by governments to deepen capital markets by improving liquidity and transparency.

- Issuance of equity and bonds to the private sector.

Asian Bank Restructuring Strategies: Interventionist vs. Market-Oriented

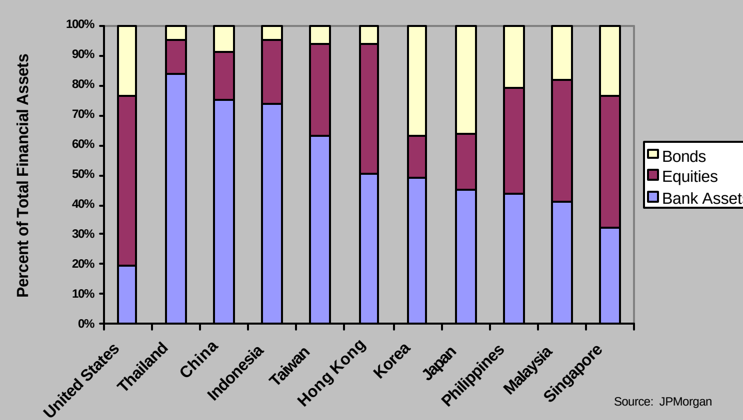
To restructure banking sectors, Asian countries, apart from Thailand, adopted an interventionist approach to bank restructuring. Under this approach, governments inject capital into banks and/or purchase problem loans, while instituting regulatory forbearance.

- **Japan:** Initially, banks were expected to cover losses on their own, and capital forbearance measures provided some time for banks to accomplish this process. But this strategy failed, created a severe lack of credit in the country, and led to a number of high profile bankruptcies. In an attempt to halt the "credit crunch" that resulted from banks' capital preservation strategies, the government injected US$62 billion in capital into the 15 largest banks. When banks regain a firm footing, they are expected to repurchase the capital injected by the government.

- **China:** The closed nature of the economy, capital controls, and

Financial Institutions Are Asia's Largest Financial Intermediaries

Chart 2:
Distribution of Financial Assets by Country: Bank Assets, Equities, and Bonds
As of Year-end 1998



Source: JPMorgan

- Financial institutions are the dominant supplier of credit in Asian markets. Based on Fitch IBCA's rakings, 89 of the top 200 banks from all emerging markets are from emerging Asian countries.

- To provide alternative sources of financing, governments are working to develop deeper capital markets. But the process will be slow as governments will have to change consumer investor preferences of bank instruments and improve corporate transparency.

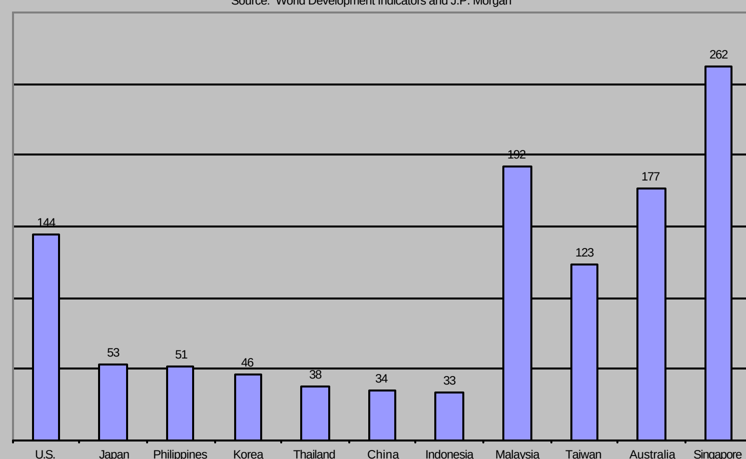
regulatory forbearance have helped the country avoid an outright banking crisis. Authorities have taken some steps to address the huge amount of problem loans in the state-owned banking sector, but the restructuring process will inevitably be long and costly. The government has injected capital into banks and is in the early stages of establishing asset management corporations to buy banks' problem loans.

- **Korea:** The government used US$37 billion to purchase problem loans at market value and to inject capital into banks. This strategy reduced nonperforming loans from 20 percent of total loans to 8 percent. The government intervened in banks that were insolvent after transferring loans at market value.

- **Indonesia:** Under a government recapitalization program announced in 1999, the government recapitalized eight private banks (included four of Indonesia's largest private banks) to a 4 percent interim capital ratio, nationalized eight other banks (including three large private banks), and closed 38 smaller banks. Owners of the eight private banks provided 20 percent of the contributed capital; the government provided 80 percent by issuing bonds (and taking equity shareholdings) and purchasing nonperforming loans. Some of these banks had capital ratios as low as negative 25 percent. Their owners still have management control and can buy back the government's share by June 2002. In November, the government recapitalized the largest state bank and plans to recapitalize three other large state banks in December 1999. These resolution activities have resulted in the effective nationalization of Indonesia's banking sector, with the government now owning more than 75 percent of banking sector assets.

<u>Equity Markets in Asia are Small</u>

Chart 3: Stock Market Capitalization as a Percentage of GDP (June 1999)
Source: World Development Indicators and J.P. Morgan



- Equity Markets in most Asian countries are small and dominated by a few large firms.
- Japan, as the second largest economy in the world, has a stock market of only 2,300 listed companies compared to 8,800 in the United States. The next largest equity market in Asia is Australia with 1,200 listed companies, followed by China at 764.
- Equity markets are less liquid. Up to half the stocks are tied up in special holdings that rarely trade. For example, in Thailand, only 30 percent of the listed stocks are available for trading.

- **Malaysia:** Operating under forbearance rules, banks had to report only those nonperforming loans past due six months or more as opposed to the previous standard of three months. An asset management corporation was established and is purchasing problem loans from banks at market value. Losses related to these loans can be amortized over five years. The asset management corporation, to date, has purchased 30 percent of total nonperforming loans. Banks requiring capital after selling loans to the government were recapitalized with public funds, giving the government an ownership interest in the banks.

- **Thailand**: In contrast to the above approaches, Thailand's approach to bank restructuring is market-oriented. The government tightened prudential regulations, primarily implementing stringent loan loss reserving policies, and gave banks until 2000 to self-recapitalize or face intervention. As a result, most banks raised significant amounts of private capital. In addition, a mechanism was developed that allowed banks to voluntarily seek government capital conditioned on the immediate compliance with new prudential standards.

Corporate Debt Restructuring: A Non-Interventionist Approach

While Asian governments are pressing banks to engage in corporate debt restructuring, the process has been largely left to the private sector with some governments facilitating the process through debt restructuring committees. The corporate sectors in Asia largely suffer from one or more of the following: high debt/equity ratios, poor profitability, and/or excess capacity. Debt restructurings to date are insignificant and when they have occurred, largely represent an extension of terms or reduced interest rates.

- **Japan:** Corporations are engaging in self-restructuring in order to improve financial performance. The primary emphasis is on cost-cutting through labor force reduction and reduced investment. Corporate balance sheet adjustment, primarily reducing debt by selling nonproductive assets, has yet to gain momentum. The process is made more difficult because Japanese banks are unwilling to forgive debt to the corporate sector, even though banks created substantial loan loss reserves.

- **China**: Restructuring of the state-owned enterprises (SOEs) is a high priority for the government. However, SOE restructuring is slowed by the adverse impact on employment, fiscal constraint to compensate for the potential losses to state-owned banks who finance SOEs' operations, and undeveloped capital markets. The government's current reform focus includes: reducing SOEs' debt and social burden (such as employees' housing, educational, and medical benefits), lowering the state's share in non-strategic SOEs, and improving SOEs' corporate governance through establishment of boards of directors.

- **Korea:** The economic engine of Korea is the productive capacity of its large chaebols, which have debt-to-equity ratios over 300 percent. The government mandated that the largest *chaebols* (industrial groupings) reduce their debt-to-equity ratios to 200 percent by the end of 1999. While debt-to-equity ratios declined from over 400 percent in 1997, the results have been achieved through revaluation of assets as opposed to actual debt reductions. In addition, the government mandated that banks reduce exposures to single entities from a maximum of 45 percent to 25 percent by 2002. Banks have entered into corporate debt restructuring agreements that rely largely on the chaebols divesting of non-strategic subsidiaries and affiliates. Debt forgiveness is not a part of the process to date, but the near bankruptcy of Daewoo Corporation may establish a framework whereby losses will be shared between the government, investors, and banks.

- **Indonesia:** The Jakarta Initiative Task Force is designed to facilitate the out-of-court voluntary restructuring of domestic and foreign corporate debt. As of July 1999, only 22 of 234 insolvent companies had reached agreements and only 10 percent of foreign and domestic debt of the Indonesian companies involved in the process had been restructured. The Indonesian Debt Restructuring Agency (INDRA), which operates like a trust fund, was recently created to facilitate the repayment of external corporate debt obligations by allowing Indonesian debtors to purchase U.S. dollars from INDRA. The framework has proven ineffective to date, in large part because Indonesian companies view the market-based exchange rate and repayment terms as unattractive.

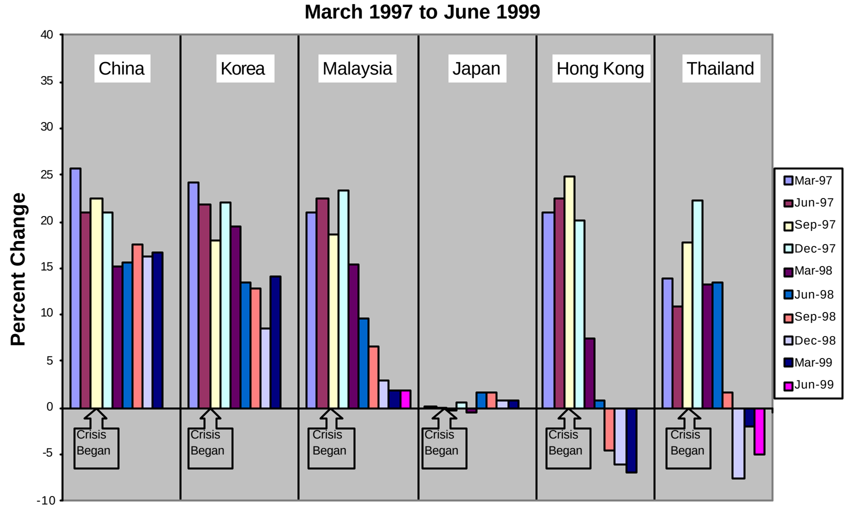
- **Malaysia:** Since the creation of a corporate debt restructuring committee, only a few companies have entered the program and have had debt restructuring programs approved.

- **Thailand:** The Corporate Debt Restructuring Committee facilitates debt negotiations between borrowers and creditors. The committee is monitoring 700 cases that represent 65 percent of outstanding credits. These cases involve syndicated credits. Banks have also initiated self-restructuring efforts, since once a debt is restructured, it is immediately removed from nonperforming loan status and is no longer classified after three payments are made. Most loan restructurings to date carry little debt forgiveness. Because of the absence of debt forgiveness, there is a real concern among banks that restructured loans will become nonperforming loans again in the future, especially with corporate debt-to-equity ratios averaging over 275 percent.

Apart from Korea and China, Credit Growth Has Not Resumed

With the exception of Korea and China, credit growth remains stagnant or negative in Asia, despite significant bank recapitalization. Korea and China are examples of just how important credit availability is to economic growth. The availability of credit in Korea, coupled with strong macro-economic adjustments, contributed to a strong economic recovery. China avoided a severe economic

Quarterly Year-on-Year Change in Bank Lending
March 1997 to June 1999



Source: IMF

downturn, in part, as a result of sustained credit growth. Meanwhile, the lack of credit in other Asian countries resulted in weaker recoveries.

- In **Japan**, what little growth in credit that has occurred is provided by government-backed entities. Credit growth by commercial banks has declined for the past 21 months.

- **Thailand's** economic recovery remains weak and fragile and led by government spending and a rebound in export growth. Outside of consumer mortgage lending and lending to exporters, credit continues to decline.

- **Malaysia's** economic recovery is similar to that of Thailand, even though the government mandated that banks achieve certain lending growth parameters. Lending has been sustained at low levels, but banks have not achieved the targets set by the government.

- While commercial banks in **Korea** are reducing their exposures to the chaebols, Korea's private investment trust companies (ITCs) stepped in to assure the availability of credit and accounts for credit growth in Korea. The ITCs are large with total assets second only to the total assets of commercial banks. Assets of the ITCs have increased by over 100 percent in the past year. Recent liquidity problems with the ITCs resulted in the Korean government pledging liquidity support to these entities, and most analysts believe that ITCs are insolvent.

- In **China**, the government encourages state-owned banks to continue lending to support the macro-economic policies of the government.

Macro-Economic Adjustments Support Growth, Micro-Level Restructuring Lags

The economic recovery process in Asia is being largely powered by swings in the trade accounts, government spending and inventory adjustment with the support of an accommodative monetary policy. These favorable factors cannot continue indefinitely. As such, a critical risk to the recovery process in the medium term is the failure to follow through with micro-level restructuring of the banking and corporate sectors. At this point, Asian governments remain committed to the restructuring process. Several measures are necessary for further progress, including**:**

- Creating incentives that encourage banks and corporations to engage in true restructuring of the corporate sector and penalties if a restructured loan becomes problematic again. Debt forgiveness by financial entities and debt-for-equity swaps should be to such an extent that viable firms will be able to service remaining debt.

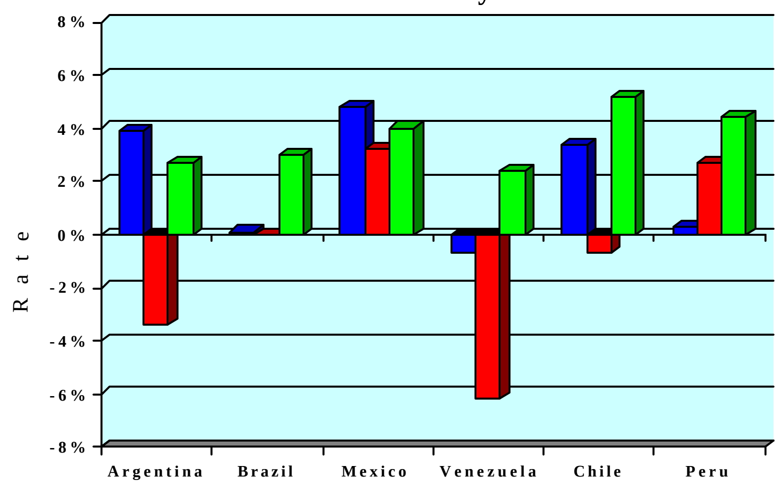
- Mechanisms for banks to obtain capital to replenish loan restructuring losses. If the corporate sector is to truly be restructured, banks will require more capital to absorb losses on debt forgiveness. Until the financial sector is comfortable that it has provided for current and future losses, it is unlikely that credit growth will resume, even though banks have liquidity and there may be viable projects to fund.

- Establishing and implementing a framework to promote deeper capital markets in order to reduce the dependence on bank credit for financing. This requires mechanisms to promote depth, liquidity, and transparency.

<u>Latin America: Economic Developments</u>

Most of the Latins appear to be at the bottom of their business cycles, with activity starting to turn up. However, the lingering effects from recessions in some countries will result in further credit quality deterioration. There are a number of downside risks, which could derail recovery, and the region remains particularly sensitive to U.S. developments. The Latins remain susceptible to higher U.S. interest rates, which may lead investors to withdraw funds from the Latin markets now that returns have risen in the United States. This will likely create a feed back effect causing Latin interest rates to rise and business activity to slow. In addition, the United States remains an important purchaser of Latin exports. If the U.S. economy slows more substantially than anticipated, sales of Latin products would be affected and production likely cut back. Other markets would be unlikely to be able to pick up the slack.

Latin Growth Expected to Resume in 2000, Albeit Slowly



Source: Consensus Economics

Finally, a number of presidential elections will result in transition governments that will need to take tough fiscal action. For example, Argentina's recently elected President De la Rúa will need to take significant fiscal measures to control the large fiscal deficit and maintain investor confidence. Cuts in Argentina's fiscal spending and/or increases in taxes will keep demand from rebounding rapidly. Presidential politics also affect Chile this fall, and Peru and Mexico next year.

Next Presidential Election

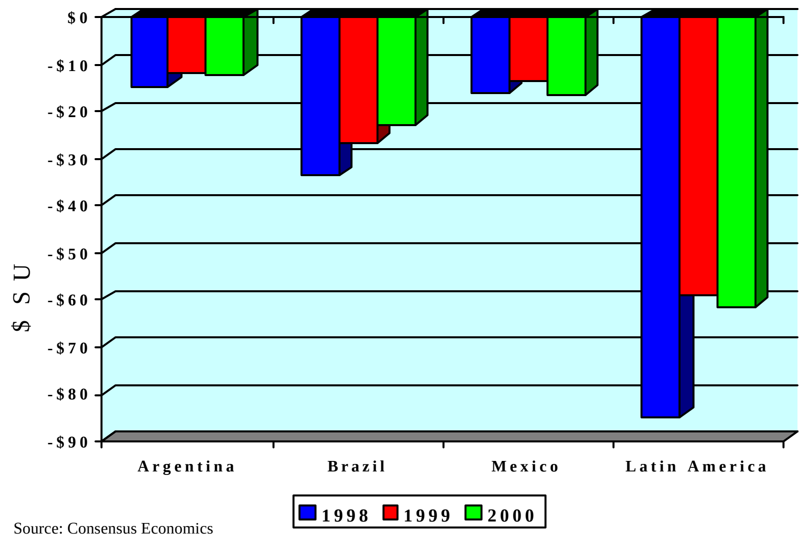
Chile	**December 1, 1999**
Peru	**April 1, 2000**
Mexico	**July 2, 2000**
Brazil	**October 1, 2002**

Source: BCP Securities, Inc.

If the global economy holds up as expected, Latin American economies should be stronger next year. The rise in oil prices is benefiting Venezuela and Mexico, whose fiscal accounts are heavily dependent on petroleum exports. For some other non-oil commodity producers, however, the pickup in global economic activity has not yet filtered down to push up raw material prices and export revenues remain weak. In addition, other factors may limit the strength of the recovery in some places. Consumer and business confidence is likely to remain subdued in several countries where presidential elections are under way, as they await clear indications of the direction of policies from the new government (especially on how they will address the deteriorating fiscal positions).

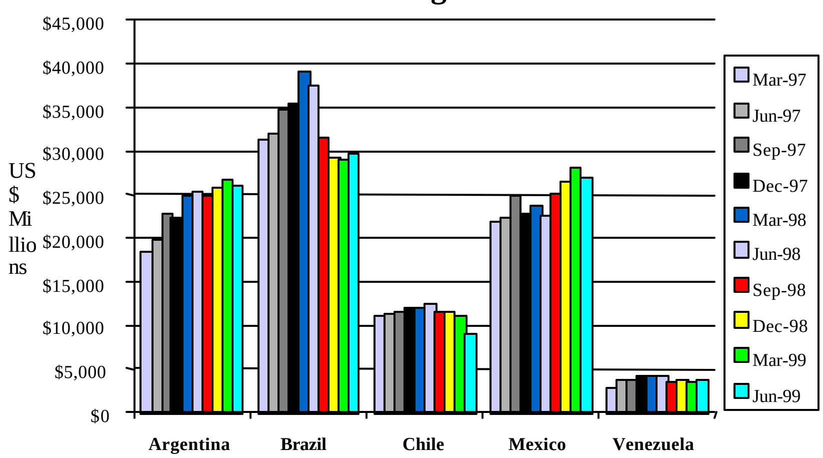
As a number of Latin economies went into recession following the floating of the *real* by Brazil in early 1999, there was widespread import compression. This has more than offset declines in exports and helped reduced the region's current account deficit from US$84.9 billion in 1998 to US$58.9 billion in 1999. The expected resumption of growth in 2000 will revive demand for imports and contribute to a slight widening of the current account deficit next year. Changes in the size of the external deficit have important implications for Latin American markets. The Latins have been very successful at attracting capital flows to fund these deficits. For the most part, foreign direct investment (FDI) flows through the privatization of state assets have been the key. But, for several of these countries, these privatizations are starting to slow down. To supplement the FDI and portfolio flows, the Latins have borrowed in the international capital markets. This borrowing has been costly in 1999 and, at times, the international markets have been too expensive for the countries to pursue new debt issues. To help alleviate this pressure, the World Bank initiated its Partial Credit Guarantee program. Taking advantage of this, Argentina was able to continue its pre-financing of its external debt at investment grade cost. Mexico did not take this approach, but arranged contingency financing from the IMF, other multilateral lenders and a North American Free Trade Agreement (NAFTA) facility

Latin Current Account Deficit Projected to Level Off in 2000, Still Requires Substantial Capital Inflows



Source: Consensus Economics

U.S. Bank Exposure to Latin America Slowing



Source: FFIEC 009 Data

totaling US$23.7 billion. The intent of the multilaterals was to help the Mexican government work its way through the current presidential elections and avoid another financial crisis.

U.S. banks have cut exposure to Latin America in the last year (See U.S. bank exposure graph, prior page) . Brazil remains the most important country in the region for our banks, despite a scaling back of exposure by $10 billion, from a March 1998 peak of almost $40 billion, in the last half of 1998. The most significant retreat this year has been in Chile, where exposure has now fallen 26 percent (or US$3.1 billion) from its high of US$12.1 billion. Mexico's economy outperformed the rest of the region in 1999, as it benefited from its close ties to the U.S. and bank exposure remained relatively stable. The expected bank exodus from Venezuela after the election of Hugo Chávez failed to materialize, although the country remains by far the least important of the big five for U.S. banks.

Latin America: Banking Developments

Summary

Domestic recessions, higher external funding costs, and market volatility produced a turbulent environment for Latin American banks over the past year. In Chile, Brazil, Argentina, and Venezuela, banks have shown resiliency. Financial sector reforms in these countries, particularly since the Mexican (Tequila) crisis in 1995, helped banks weather the external shocks of the Asian crisis and more recent woes in individual economies. Government-led bank consolidation, coupled with foreign bank expansion and improving regulation contributed to systemic stability.

In contrast, banks in Ecuador and public banks in Colombia, where financial reforms lag and recessions have been sharp, face severe distress. Despite an improving economy, Mexican banks remain frail, still lacking the capital required to generate significant earnings. In Central America, banking sectors are weakened by high interest rates and sluggish credit demand.

Asset quality has suffered throughout the region (see "Loan Delinquencies"graph next page), and credit growth has been flat. These conditions may stabilize, but may not improve soon. Leading banks, including foreign banks, remain positioned to weather, and potentially benefit from, the turmoil because of their strong franchises, capital base, and expected access to domestic and international capital markets. But mid- to small-sized banks in Argentina, Brazil, Venezuela, and Peru find themselves increasingly challenged by competition, and reduced access to liquidity and capital. The result is likely to be more bank resolutions and mergers. In Argentina and Venezuela, insufficient deposit insurance will slow the pace of resolutions and mergers. While the entire region is unlikely to experience the sort of severe banking problems seen recently in Ecuador, Colombia, or Mexico, the difficult operating environment should continue in 2000.

Issues to Watch

- Impact of lingering recessions and fledging recoveries on credit growth, asset quality, and bank profits, particularly in Argentina, Brazil, Chile, and Peru.

- Banks' access to domestic and international funding given the negative operating environment and the potential impact of the year-2000 conversion on financial markets.

- Progress in restructuring troubled banking sectors in Mexico, Colombia, Ecuador.

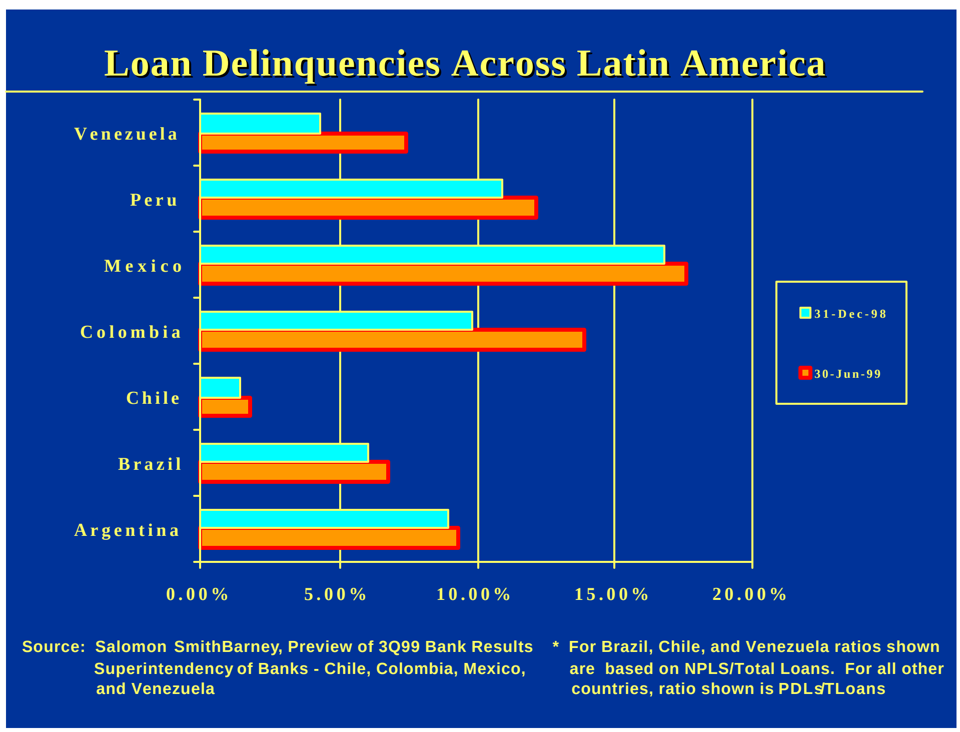
- Trends in strengthening financial transparency and bank supervision: Venezuela's adoption of inflation-adjusted accounting; Brazil's expansion of market risk limits on new products, adoption of a loan classification system, and measures to increase institutional capacity to examine banks; bank interventions and resolutions, and the shoring up of deposit insurance funds in Argentina and Venezuela.

- Foreign bank expansion, and evolution of regional networks led by Spanish banks; effects on the perception of systemic risk in the region.

Key Factors Affecting Banks and Supervision

Prospects will depend largely on the extent of recovery in individual economies in 2000. Key factors shaping the banking environment include:

- **Economic Conditions**. Slumping economic conditions have slowed the demand for credit, and worsened credit quality. Past-due loans have risen throughout the region in the past six months, though asset quality deterioration seems to be slowing in Chile and Colombia. In many cases, deterioration appears most notable in consumer, leasing, and small- to-mid-size business loan portfolios. Public banks are carrying the heaviest levels of problem assets in most countries. Leading private banks, including those in Brazil, Chile, Argentina, and Peru, are maintaining adequate capital and, in a sense, have benefited from the regional slump: the stressed economy has produced a flight to quality, in which deposits, corporate and trade finance, and cash management services have moved from the smaller banks to the leading banks. Leading banks, however, appear to have shelved plans for a major expansion into the mid-size



Source: Salomon SmithBarney, Preview of 3Q99 Bank Results Superintendency of Banks - Chile, Colombia, Mexico, and Venezuela
* For Brazil, Chile, and Venezuela ratios shown are based on NPLS/Total Loans. For all other countries, ratio shown is PDLs/TLoans

business and consumer sectors, shifting their focus back to large corporate clients, asset management, and private banking.

- **Market Volatility**. With more and more Latin countries relying on floating exchange rates (Chile being the most recent to scrap the currency band), banks increasingly need products to hedge against currency volatility. As banks have diversified their holdings, and expanded their trading of various assets, swings in interest rates, and in bond, equity, and commodity prices, have added to banks' needs for tools to limit risk.

- **Consolidation.** Latin banks continue to follow global trends towards domination by a few mega-banks, with the large Spanish banks continuing to acquire Latin banks with significant domestic market share. The merger between Banco Santander and Banco Central Hispano positions the combined bank as the dominant foreign bank in Latin America. Similarly, Banco Bilbao Vizcaya's purchase of Provida, a leading Chilean private pension-fund asset management company, makes the bank a leader in pension fund management in Latin America. Other mergers and acquisitions have occurred in Argentina and Peru, the result of orderly bank resolutions.

  Consolidation is likely to continue. For distressed banks (which are most likely to be small- to mid-size private banks), the speed of resolution will depend on how much deposit insurance money is available. The most significant acquisitions are expected to occur in Brazil, where the long-delayed privatization of several large state-owned institutions may go forward in 2000; moreover, many small banks lack the economies of scale to remain competitive in the medium-to-longer term, and will most likely be absorbed by larger players.

- **Growing Foreign Bank Presence**. According to Salomon Smith Barney, foreign banks controlled 27% of loans and 31% of deposits in Latin America as of June 30, 1999, up from 23% and 30%, respectively, a year ago. The leading foreign banks are listed below.

Top Foreign Banks by Loans Controlled, June 30, 1999 (Billions US$)

	Argentina	**Brazil**	**Chile**	**Colombia**	**Mexico**	**Peru**	**Venezuela**	Total	Pct Total (c)
BSCH(a)	5.94	1.7	12.29	.8	5.02	1.3	.97	28.02	**6.8%**
BBV(b)	5.0	.32	2.18	1.55	5.78	---	1.68	16.51	**4.0%**
Citibank	4.65	2.5	1.97	.9	5.48	.53	.43	16.46	**4.0%**
Bank Boston	5.61	1.68	.50	.075	.071	.055	---	7.99	**1.9%**

Source: Salomon Smith Barney, October 6, 1999.
a) Banco Santander Central Hispano, largest Spanish bank;
b) Banco Bilbao Vizcaya, second largest Spanish bank;
c)Percentage of total loans controlled in Latin America.

Foreign bank expansion in the region is widely credited with lowering systemic risk, as evidenced in Argentina (foreign bank share 43 percent), Venezuela (42 percent) and Peru (57 percent). There is no widespread opposition to the principle of increased foreign bank entry, although BSCH's market share in Chile (roughly 30 percent) is causing concern. Foreign banks have stimulated competition in many countries, squeezing profit margins and pushing local banks to reduce overhead and strive to make more effective use of technology. Competitive pressures will continue to fuel consolidation as leading banks push for increased market share.

Developments in the Southern Cone

In the Southern Cone region, **Brazil's** banks remain stable. Leading private banks' profits are absorbing higher charge-offs, replenishing reserves, and maintaining sufficient capital. Trading and investment income from large holdings of government paper (banks hold 60 percent of the total) boosted banks' revenues, even as loan growth remained flat over the past year. To bring down consumer interest rates (over 100 percent, compared to overnight rates of 19 percent) and spur credit growth, the government reduced the tax on consumer loans from 6 percent to 1.5 percent, and eliminated reserve requirements (which were 10 percent) on time deposits. Efforts to reinforce supervision continue. The Central Bank has strengthened market risk regulations, and is working on a risk-based loan classification system to combine with its centralized credit risk bureau, measures which are expected to improve the assessment of credit quality. The Central Bank has been conducting more comprehensive examinations of the larger private banks, and intends to expand examinations of public banks, which could identify a significant need for capital. This plan may be hampered, however, by the lack of skilled inspectors.

In **Argentina**, the banking sector, although stable, is under stress. Past-due loans are high, at 9.31 percent of total loans at June 30, 1999, an increase from 8.44 percent at year-end 1998, as a result of the deteriorating economy. No reversal of loan deterioration is expected soon. Confidence in the banking system, however, remains good. Bank deposits grew 1 percent during the third quarter 1999, although the shift from peso to dollar deposits intensified. Credit demand remains sluggish, with growth driven by loans to companies owned by the federal and state governments. Early actions by the newly elected De la Rda government, coupled with positive economic numbers expected in the first quarter of 2000, may help boost confidence and spur credit growth. But conditions will remain tenuous for the banking sector, particularly for mid- to small-size banks. In recent quarters, the Central Bank has demonstrated increasing skill in bank failure management; this has increased depositor confidence. However, scarce deposit insurance funds exacerbate the already complicated task of achieving orderly resolutions.

In **Chile,** the banking sector remains resilient, but the negative operating environment has continued to dampen credit demand and adversely affect asset quality. Nonperforming loans remain low by international standards, at 1.73 percent of total loans at June 30, 1999, up from 0.97% in December 1998, but slightly down from the first quarter 1999. If Chilean banks were required to report publicly the full amount of nonperforming loans (both interest and principal), these figures would roughly double but would still be manageable by international standards. Competition in the Chilean market has intensified, with the expansion of foreign banks causing significant restructuring and alliances. The merger between Banco Santander and Banco Central Hispano, which gave BSCH a nearly 30 percent market share in the system, stimulated more transactions, including Banco Bilbao Viscaya's purchase of Provida mentioned earlier; Scotiabank's take over of Banco Sud Americano, and the Chilean Luksic group's acquisition of Banco Edwards, a prominent wholesale bank.

Developments in the Andean Region

Asset quality continued to deteriorate for banks in **Colombia, Peru,** and **Venezuela,** largely as a consequence of slowing economies and high interest rates employed to defend national currencies. In **Colombia,** problems at top-tier private banks appear to be contained so far. But the government's recent infusion of US$3 billion into the troubled public sector banks (largely savings and loans) is not likely to be enough. System-wide past due loan figures show a slowing of asset quality deterioration (13.3 percent in September 1999, down from 14.3 percent in May); analysts attribute the drop to widespread loan restructurings and write-offs. The central bank has been able to lower interest rates, but another spike could be a major blow to the fragile banking system.

The high concentration of major international banks in **Venezuela** and **Peru** has stabilized the banking sectors in these countries. But Venezuelan authorities continue to face a major challenge in consolidating the banking sector, which includes numerous small banks that lack a niche or other economic attractiveness. **Ecuador**, which lags the rest of Latin America in political, supervisory, and economic reform, has now experienced a financial-system meltdown. Four of the country's five largest banks have failed. The Ecuadorian congress remains stubbornly opposed to IMF demands, which must be met before a multilateral financial aid package can be approved.

Mexico and Central America

In spite of recent government efforts to strengthen the banking sector and improve bank earnings, **Mexican** banks remain weak, with high levels of troubled loans, and illiquid investment portfolios. Most Mexican banks lack funds to lend, and labor under a weak and obsolete legal framework. Proposals to grant banks the right to enforce collateral and loan guarantees have been politically contentious, and will become more contentious with congressional and presidential elections approaching. Recently announced accounting changes that would strengthen banks' capital base will be phased in gradually and thus will not have an immediate positive impact.

In **Central America**, the major banking sectors (**El Salvador** and **Guatemala**) are experiencing the effects of rapid credit expansion of the last few years, followed by a sharp deceleration of credit demand owing to a tighter monetary policy and slowing economies. A few countries have been successful in pushing measures to increase capital adequacy ratios, strengthen consolidated financial reporting, and tighten limits on related lending. But bank supervision remains weak, with Central America lagging the more developed banking sectors to the south in financial transparency.

APPENDIX

Western Europe Bank and Insurance Data
TABLE 1--Europe's Top Banks
(European Banks Among the World's 50 Largest Banks[1])

Rank 1998	1997	Company (Country)	Total Banking Assets (in $ mil)
1	3	Deutsche Bank (Germany)	$705,710(1)
2	1	UBS (Switzerland) *	683,358
6	11	ABN AMRO (Netherlands)	504,889
7	59	HSBC Holdings (UK/Hong Kong)	475,546
8	7	Credit Suisse Group (Switzerland)*	474,256
9	33/45	Bayerische Hypotheken & Vereinsbank (Germany)	473,315(2)
12	10	Credit Agricole (France)	456,465
13	12	Societe Generale (France)	448,158
17	21	Westdeutsche Landesbank (Germany)	403,698
19	17	Dresdner Bank (Germany)	396,585
21	20	Banque Nationale de Paris (France)	379,559(3)
22	26	Commerzbank (Germany)	375,626
24	16	Barclays (UK)	353,354
27	23	ING Group (Netherlands)#	327,311
28	27	Fortis Group (Belgium/Netherlands)#	324,022
29	24	National Westminster Bank (UK)	297,461
30	41	Rabobank Group (Netherlands)	291,795
31	35	Paribas (France)	291,230(3)
32	52	Banco Santander Central Hispano (Spain)	274,087(4)
33	34	Abbey National (UK)	273,537
35	37	Bayerische Landesbank (Germany)	263,165
38	46	DG Bank (Germany)	256,614
39	32	Credit Lyonnais (France)	244,074
40	36	Lloyds TSB Group (UK)	240,073
44	39	Groupe Caisse d Epargne (France)	236,015
45	44	Group Dexia (Belgium)	232,928
46	48	Bankgesellschaft Berlin (Germany)	217,682
47	53	Halifax (UK)	208,722

\# These are mixed banking, securities and insurance conglomerates. Ranking is based only on banking assets as reported here.

(1) Does not reflect June 1999 acquisition of Bankers Trust; combined assets based on 6/30/99 data totaled $877 billion.

(2) Pro-forma figures reflecting merger of Bayerische Hypotheken and Bayerische Vereinsbank.

(3) Does not reflect Sept. 1999 acquisition of Paribas by Banque National de Paris; combined assets based on 1998 figures totaled $ 670.8 billion changing its ranking to #3.

(4) Figures are pro-forma and reflect the April 1999 merger of Banco Santander and Banco Central Hispano.

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[1] From Wall Street Journal, September 27, 1999, "World Business" section, page R31, based on 12/31/98 data. 26 are in the EU. Switzerland is not an EU country.

Western Europe Bank and Insurance Data
TABLE 2--Recent European Bank Mergers

Bid Date	Acquirer/Country	Target/Country
Nov. '98	Deutsche Bank (Germany) (Value: $9 B)	Bankers Trust Corp (US) **[approved]**
Jan. '99	Banco Santander (Spain) (Value: $11.4 B)	Banco Central Hispanoamericano (Spain) **[approved]**
Jan. '99	Storebrand ASA (Norway, insurer) (Value: NOK 1.6 B)	Finansbanken (Norway) **[approved]**
Feb. '99	Societe Generale (France) (Value: $18 B)	Paribas (France) **[cancelled]**
Mar. '99	Banque Nationale de Paris (France) (Value: $39 B)	Paribas (France) **[approved]** Societe Generale (France) **[cancelled]**
Mar. '99	UniCredito (Italy) (Value: $16.5B)	Banca Commerciale Italiana (Italy) **[blocked]**
Mar. '99	San Paolo IMI (Italy) (Value: $10 B)	Banca di Roma (Italy) **[blocked]**
May '99	Bank of Ireland (Ireland)	Alliance and Leicester (UK) **[cancelled]**
May '99	HSBC Holdings (UK) (Value: $10.3 B)	Republic NY Corp (US), Safra Republic Holdings (Luxembourg) **[pending]**
June '99	Banco Santander Central Hispano (Spain)	40% of Mundial Confianca (insurance unit holding the Champalimaud Financial Group) (Portugal) **[denied]**
June '99/ Oct. '99	Banco Comercial Portugues (Portugal) (Value: EUR 4.5B)	Champalimaud Financial Group (Portugal) **[on hold]**
June '99	Unibank (Denmark)	Tryg-Baltica (Denmark s largest non-life insurance company) **[approved]**
June '99	Unicredito (Italy)	Bank Polska Kasa Opieki SA -Grupa Pekao SA (Poland) **[approved]**
June '99	Banca Intesa (Italy) (Value: $15 B)	Banca Commerciale Italiana (Italy) **[approved]**
Aug. '99	Deutsche Bank (Germany)	Dresdner Bank (Germany) **[cancelled]**
Aug. '99	Artesia Banking Corp. (Belgium)	Banque Vernes (French) **[approved]**
Aug. '99	ING (Netherlands) (Value: EUR 3B)	BHF-Bank (Germany) **[approved]**
Sept. '99	Banco Bilboa Vizcaya (Spain) (Value: $11.3 B)	Argentaria, Caja Postal y Banco Hipotecario (Spain) **[approved]**
Sept. '99	National Westminster Bank (UK) (Value: 10.7 B)	Legal & General (UK - insurance) **[cancelled]**
Sept. '99	Bank of Scotland (UK) (Value: 21.2 B)	National Westminster Bank (UK) **[pending]**
Sept. '99	MeritaNordbanken (Finland-Sweden) (Value: $3.1 B)	Christiana Bank og Kreditkasse (Norway) **[denied/ still pending]**
Sept. '99	Assicurazioni Generali (Italy -insurance) (Value: $12.8 B)	Istituto Nazionale delle Assicurazioni (INA) (Italy - insurance) **[pending]**

Bid Date	Acquirer/Country	Target/Country
Sept. '99	San Paolo IMI (Italy)	Istituto Nazionale delle Assicurazioni (INA) (Italy - insurance) **[pending]**
Sept. '99	Banque Nationale de Paris (France)	Dresdner Bank (Germany) **(Talking stage)**
Sept. '99	Dexia Belgium (Belgium) (Value: EUR 5.9B)	Dexia France (France) **[pending]**
Sept. '99	Erste Bank (Austria)	Ceska Sporitelna (Czech Republic) **(Talking stage)**
Oct. '99	Skandinaviska Enskilda Banken (SEB) (Sweden) to acquire from Credit Lyonnais (50%), BGAG (25%) and AMB (25%) (Value: $1.7 B)	BfG Bank (BfG) (Germany) **[pending]**
Oct. '99	Banco Bilboa Vizcaya (Spain)	UniCredito Italiano (Italy) **[pending]**
Oct. '99	Dresdner Bank (Germany)	HypoVereinsbank (Germany) **(Talking stage)**
Oct. '99	Den Danske Bank (Denmark)	Fokus Bank (Denmark) **[pending]**
Oct. '99	Norwich Union (UK life assurer)	Caixa Catalunya (Spain) **[pending]**
Oct. '99	Sampo (Finland - insurer)	Leonia Bank (Finland) **[pending]**
Oct. '99	Rabobank Group (The Netherlands) (50-50 Joint Venture)	Deutsche Genossenschaftsbank (Germany) **[pending]**
Nov. '99	Allianz (Germany - insurer) (Value: $3.3B)	Pimco Advisors (US) 70% stake **[pending]**

Western Europe Bank and Insurance Data
TABLE 3--Europe's Top Insurers
(European Insurers Among World's 50 Largest[2])

Rank 1998	Rank 1997	Company (Country)	Total Insurance Assets (in $ mil)
1	1	AXA Group (France)	$449,556
2	3	Allianz Group (Germany)	401,406
9	18	Zurich Financial Services Group (Switz.)*	205,963
10	9	Prudential Corp. (UK)	196,536
12	12	Assicurazioni Generali (Italy)	177,207
13	11	CGU (UK)	168,181
14	13	Aegon Group (Netherlands)	153,745
17	16	ING Group (Netherlands)#	141,418
18	17	Munich Reinsurance (Germany)	135,845
19	22	Legal & General Group (UK)	130,309
20	--	CNP assurance Vie (France)	117,381
22	27	Standard Life Assurance (UK)	107,825
27	21	Royal & Sun Alliance (UK)	102,777
29	28	Norwich Union (UK)	98,774
33	35	Winterthur (Switzerland)*	89,013
37	38	Swiss Life Rentenanstalt (Switzerland)*	85,414
41	--	Predica (France)	75,939
43	45	Fortis Group (Belgium/Netherlands)#	69,090
45	--	Groupama-Gan (France)	66,374
46	47	Swiss Re Group (Switzerland)*	64,187

* Switzerland is NOT an EU country.
\# These are mixed banking, securities and insurance conglomerates. Ranking is based only on insurance assets as reported here.

[2] From Wall Street Journal, September 27, 1999, "World Business" section, page R30, based on 12/31/98 data. 16 are in the EU, and 1/3 are in the UK.